APPENDIX A

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 93-1377

PHILLIPS PETROLEUM COMPANY,

Plaintiff-Appellant,

v.

GARY JOHNSON, Area Manager,
Dallas Area Compliance Office,
Minerals Management Service, et al.,

Defendants-Appellees.

ATLANTIC RICHFIELD COMPANY,

Plaintiff-Appellant,

v.

BRUCE BABBITT,
Secretary of Department of Interior, et al.,

Defendants-Appellees.

PHILLIPS PETROLEUM COMPANY,

Plaintiff-Appellant,

v.

GARY JOHNSON, Area Manager,
Dallas Area Compliance Office,
Minerals Management Service, et al.,

Defendants-Appellees.

PHILLIPS PETROLEUM COMPANY,

Plaintiff-Appellant,

v.

GARY JOHNSON, Area Manager,
Dallas Area Compliance Office,
Minerals Management Service, et al.,

Defendants-Appellees.

Appeals from the United States District Court
for the Northern District of Texas

(CA3:89-1707-H c/w 3:89-2393-H;
3:89-2727-H & 3:89-2751-H)

[Filed September 7, 1994]

ON PETITION FOR REHEARING AND
SUGGESTION FOR REHEARING EN BANC

Before SMITH and BARKSDALE, Circuit Judges, and WALTER,* District Judge.

JERRY E. SMITH, Circuit Judge:**

No member of this panel nor Judge in regular active service on the court having requested that the court be polled on rehearing en banc, the suggestion for rehearing en banc is

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* District Judge of the Western District of Louisiana, sitting by designation.

** Local Rule 47.5.1 provides "The publication of opinions that have no precedential value and merely decide particular cases on the basis of well-settled principles of law imposes needless expense on the public and burdens on the legal profession." Pursuant to that rule, the court has determined that this opinion should not be published.

DENIED. The petition for rehearing is GRANTED so that we may address an issue that we inadvertently omitted from our previous opinion in this case. This supplemental opinion modifies our opinion issued on June 10, 1994, 22 F.3d 616 (5th Cir. 1994).

We previously reversed the district court's grant of summary judgment to defendants because we concluded that the MMS Procedure Paper was a substantive rule promulgated without notice and comment. Two of the four consolidated cases did not, however, involve the Procedure Paper. Concluding that the statute of limitations does not bar the agency's action, we affirm the district court's grant of summary judgment to defendants in those cases.

I.

Phillips contends that the MMS orders are invalid, as they cover royalties due from a period outside the six-year limitation period imposed by 28 U.S.C. § 2415(a), which bars "every action for money damages" brought by the United States unless the "complaint is filed within six years." Phillips and ARCO contend that (1) MMS orders are "actions," and (2) royalty demands are actions "for money damages."

The term "action for money damages" refers to a suit in court seeking compensatory damages. The plain meaning of the statute bars "every action for money damages" unless "*the complaint* is filed" within six years." (Emphasis added.) Thus, actions for money damages are commenced by filing a complaint. Actions that do not involve the filing of a complaint are not "action[s] for money damages." Since the government has filed no complaint,[1] the agency action is not an "action for money damages." Thus, § 2415 is no bar.

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[1] This suit is for declaratory judgment brought by Phillips and ARCO; moreover, the agency order cannot be construed as a complaint.

In addition, the meaning of the phrase "money damages" is narrowly construed. *See Bowen v. Massachusetts*, 487 U.S. 879, 893 (1988) ("The fact that a judicial remedy may require one party to pay money to another is not sufficient reason to characterize the relief as 'money damages.'"). "Money damages" normally refers to a sum of money used as compensatory relief. *Id.* at 897.

By contrast, orders issued by MMS seek monies due under a contract with the government. Such contractual obligations cannot be considered compensatory. Agency orders are therefore not barred by the limitations period of § 2415. Consequently, we affirm the district court's grant of summary judgment to defendants on those causes not affected by the Procedure Paper. In all other respects, our prior opinion is unmodified. The judgment is AFFIRMED IN PART and REVERSED IN PART.

APPENDIX B

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 93-1377

PHILLIPS PETROLEUM COMPANY,

Plaintiff-Appellant,

v.

GARY JOHNSON, Area Manager, Dallas Area Compliance Office, Minerals Management Service, et al., Defendants-Appellees.

ATLANTIC RICHFIELD COMPANY,

Plaintiff-Appellant,

v.

BRUCE BABBITT, Secretary of Department of Interior, et al., Defendants-Appellees.

PHILLIPS PETROLEUM COMPANY,

Plaintiff-Appellant,

v.

GARY JOHNSON, Area Manager, Dallas Area Compliance Office, Minerals Management Service, et al., Defendants-Appellees.

PHILLIPS PETROLEUM COMPANY,

Plaintiff-Appellant,

v.

GARY JOHNSON, Area Manager, Dallas Area Compliance Office, Minerals Management Service, et al., Defendants-Appellees.

June 10, 1994

Before SMITH and BARKSDALE, Circuit Judges, WALTER,* District Judge.

JERRY E. SMITH, Circuit Judge:

In this consolidated appeal, plaintiffs Phillips Petroleum Company ("Phillips") and Atlantic Richfield Company ("Arco") appeal a summary judgment. Phillips and Arco contend that (1) the six-year limitations period of 28 U.S.C. § 2415(a) barred the administrative order issued by Minerals Management Service ("MMS") of the Department of Interior ("DOI") requiring the recalculation and payment of additional oil and gas royalties based upon an unpublished MMS royalty-valuation procedure (the "Procedure Paper"); (2) defendants failed properly to initiate an audit pursuant to the Federal Oil and Gas Royalty Management Act ("FOGRMA"), 30 U.S.C. §§ 1701-1757; and (3) MMS promulgated the Procedure Paper without notice and comment required under the Administrative Procedure Act of 1982 ("APA"), 5 U.S.C. §§ 552, 553. Phillips further asserts that defendants failed to comply with the Paperwork Reduction Act, 44 U.S.C. §§ 3501-3520. Concluding that MMS promulgated a substantive rule without notice and comment, we reverse.

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* District Judge of the Western District of Louisiana, sitting by designation.

I.

A.

DOI is responsible for issuing and administering oil and gas leases for federal lands. 30 U.S.C. §§ 181, 223-237. FOGRMA directs the Secretary of Interior (the "Secretary") to establish "a comprehensive inspection, collection and fiscal and production accounting and auditing system to provide the capability to accurately determine oil and gas royalties, interest, fines, penalties, fees, deposits. and other payments owed, and to collect and account for such amounts in a timely manner." 30 U.S.C. § 1711(a). FOGRMA further provides that the Secretary "shall audit and reconcile, to the extent practicable, all current and past lease accounts for leases of oil or gas and take appropriate actions to make additional collections or refunds as warranted, . . . [and] may also audit accounts and records of selected lessees and operators." *Id.* § 1711(c)(1). MMS is the agency within the DOI that is responsible for auditing royalty payments on federal and Indian oil and gas leases.

Phillips and Arco hold numerous leases on federal and offshore lands. As lessees, they pay royalties to the government based upon the value of the production saved, removed, or sold from the leased premises. Up until March 1, 1988, DOI considered several factors in determining the value of federal offshore production for royalty purposes:

> The value of production shall never be less than fair market value. The value used in the computation of royalty shall be determined by the Director. In establishing the value, the Director shall consider: (a) The highest price paid for a part or for a majority of like-quality products produced from the field or area; (b) the price received by the lessee; (c) posted prices; (d) regulated prices; and (e) other relevant matters. Under no circumstances shall the value of production be less than the gross proceeds

> accruing to the lessee from the disposition of the produced substances or less than the value computed on the reasonable unit value established by the Secretary.

30 C.F.R. § 206.150 (1987).

On December 14, 1984, MMS developed new criteria for valuing natural gas liquid products ("NGLP's"),[1] as set forth in an unpublished internal agency paper referred to as the "Procedure Paper." Instead of considering the range of the various types of prices prescribed in the governing regulation, the Procedure Paper focused entirely upon one type of price, the spot market price:

> MMS will take the highest and lowest published price for the month from the appropriate [spot market price] bulletin. If the reported price [by the lessee] falls within this range, the [lessee's] value will normally be accepted by MMS for royalty determination purposes. . . .
>
> . . . .
>
> If the prices used to calculate royalties fall below this range, a minimum value that is acceptable to MMS can be determined by developing an average value from the lowest and highest prices in the range.

In a September 6, 1989, order, MMS advised Arco that it had audited royalty payments under five of Arco's federal offshore leases for the month of September 1983. MMS directed Arco to recalculate its royalties under the five leases,

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[1] When natural gas is produced that contains a high volume of liquefiable hydrocarbons (commonly known as "wet" gas), the gas is sometimes processed to separate the liquids from the dry methane, or "residue," gas. The liquids are then fractionated to separate the NGLP's, such as ethane, propane, butane, and natural gasoline.

using the Procedure Paper, for the period 1983-1989. In a September 7, 1989, order, MMS required Arco to recalculate and pay additional royalties for all federal offshore leases from 1983 to 1989. MMS sent Arco another order on September 29, 1989, requiring Arco to recalculate its royalties using the Procedure Paper for all federal offshore leases for a period from October 1980 to February 1988. MMS sent similar orders to Phillips in September 1989, requiring Phillips to recalculate and pay additional royalties, using the Procedure Paper, on all offshore leases between January 1977 and February 1988.

B.

Phillips filed three separate suits for declaratory and injunctive relief, disputing the validity of the MMS orders; at about the same time, Arco filed a similar action in the same court. The four cases were consolidated, and the parties filed cross-motions for summary judgment. The district court allowed the government to file a counterclaim seeking judicial enforcement of the orders, concluding that the statute of limitations provision of 28 U.S.C. § 2415(a) did not apply to the contested orders, and granted summary judgment on the government's counterclaim.

II.

The Procedure Paper is a "rule," and its promulgation constituted "rulemaking" within the meaning of the APA.[2]

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[2] Title 5 U.S.C. § 551(4) defines a "rule" as "an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy or describing the organization, procedure, or practice requirements of an agency and includes [various substantive agency functions] or practices bearing on any of the foregoing." Section 551(5) defines "rulemaking" as "agency process for formulating, amending, or repealing a rule." Indeed, MMS does not argue that its action was not rulemaking but only that the Procedure Paper was exempt from the APA's notice and comment provisions.

Section 553 of the APA provides that an agency must provide notice of a proposed rule in the Federal Register and afford an opportunity for interested persons to present their views. 5 U.S.C. § 553(b), (c). The required publication must be made not less than thirty days before the effective date of the proposed rule. *Id.* § 553(d). In promulgating the Procedure Paper, MMS did not attempt to comport with these requirements, as it argues that the requirements of § 553 do not apply to the APA.

The APA exempts "interpretative rules, general statements of policy, [and] rules of agency organization, procedure, or practice" from the notice and comment requirements. *Id.* § 553(b)(A). In the Procedure Paper itself, MMS attempted to avoid the notice and comment requirements of the APA by characterizing the rule as a "yardstick." The Interior Board of Land Appeals called the rule "essentially a policy guideline." *Conoco & ARCO Oil & Gas Co.*, 110 IBLA 232, 242-43 (1989). This court, however, must determine the category into which the rule falls: "[T]he label that the particular agency puts upon its given exercise of administrative power is not, for our purposes, conclusive; rather it is what the agency does in fact." *Brown Express, Inc. v. United States*, 607 F.2d 695, 700 (5th Cir.1979) (quoting *Lewis-Mota v. Secretary of Labor,* 469 F.2d 478, 481 (2d Cir.1972)). We review this legal issue *de novo*. *See Munn v. Algee,* 924 F.2d 568, 575 (5th Cir.), *cert. denied,* ___ U.S. ___, 112 S.Ct. 277, 116 L.Ed.2d 229 (1991).

A.

MMS argues that the Procedure Paper merely interprets the existing royalty valuation regulation in the context of NGLP's used internally and not sold. It is therefore a clarification or explanation of existing laws and regulations rather than a substantive modification of existing regulations or adoption of new ones. *See Continental Oil Co. v. Burns,*

317 F.Supp. 194, 197 (D.Del.1970). Consequently, MMS concludes, the Procedure Paper is exempt from the notice and comment requirements as an "interpretative rule."

"Interpretative rules" have been defined by this court in *Brown Express*: "Generally speaking, it seems to be established that 'regulations,' 'substantive rules,' or 'legislative rules' are those which create law, usually implementary to an existing law; whereas interpretative rules are statements as to what the administrative officer thinks the statute or regulation means." *Brown Express,* 607 F.2d at 700 (quoting *Gibson Wine Co. v. Snyder,* 194 F.2d 329, 331 (D.C.Cir.1952)). The Procedure Paper is not an interpretative rule, as it does not purport to interpret a statute or regulation. Notwithstanding MMS' assertion that the Procedure Paper announced the approach MMS would take in interpreting and applying 30 C.F.R. § 206.150, the Procedure Paper is not a mere clarification. It defines no ambiguous term. It gives no officer's opinion about the meaning of the statute or regulations. Rather, it effects a change in the method used by MMS in valuing NGLP's.[3] As such, it is a new rule and cannot be interpretative. Brown Express, 607 F.2d at 700.

B.

MMS also contends that the Procedure Paper may be characterized as a "general statement of MMS policy." A general statement of policy is a statement by an administrative agency announcing motivating factors the agency will consider, or tentative goals toward which it will aim, in

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[3] MMS claims that the Procedure Paper effects no change because MMS could have used spot market prices to value NGLP's not sold. Under 30 C.F.R. § 206.150, "posted prices" are but one factor to be used in valuing NGLP royalties. And rules are viewed as substantive when they "constrict the discretion of agency officials by largely determining the issue addressed." *Batterton v. Marshall,* 648 F.2d 694, 702 (D.C.Cir.1980) (footnote omitted).

determining the resolution of a substantive question of regulation. *Id.* at 701.

> A general statement of policy . . . is merely an announcement to the public of the policy which the agency hopes to implement in future rulemakings or adjudications. A general statement of policy, like a press release, presages an upcoming rulemaking or announces the course which the agency intends to follow in future adjudications.

Id. (quoting *Pacific Gas & Elec. Co. v. FPC,* 506 F.2d 33, 38 (D.C.Cir.1974)). The Procedure Paper, however, does none of these things. It does not set a goal that future proceedings may achieve, for the change has already been made. Immediately upon its effective date, the five-factor valuation technique of 30 C.F.R. § 206.150 was no longer to be followed. An announcement stating a change in the method by which an agency will value NGLP's is not a "general statement of policy." Thus, the Procedure Paper is not exempt from APA requirements as a "general statement of policy."

C.

Section 553(b)(A) also exempts "rules of agency organization, procedure, or practice." Although the Procedure Paper would appear to fall squarely within this exemption, for the change effected by the Procedure Paper plainly relates to the internal practices of MMS, the mere fact that it may guide MMS procedures does not mean that the Procedure Paper is a "procedural" rule for purposes of the APA.

The Supreme Court has stated that the notice and comment provisions "were designed to assure fairness and mature consideration of rules of general application." *NLRB v. Wyman-Gordon Co.,* 394 U.S. 759, 764, 89 S.Ct. 1426, 1429, 22 L.Ed.2d 709 (1969). These provisions afford an opportunity for "the agency promulgating the rule to educate

itself before establishing rules and procedures which have a substantial impact on those regulated." *Texaco, Inc. v. Federal Power Comm'n*, 412 F.2d 740, 744 (3d Cir. 1969). Congress realized that an agency's judgment would be only as good as the information upon which it drew. It prescribed these procedures to ensure that the broadest base of information would be provided to the agency by those most interested and perhaps best informed on the subject of the rulemaking at hand. *See Shell Oil Co. v. Federal Energy Admin.*, 574 F.2d 512, 516 (Temp. Emer. Ct. App. 1978).

The proper test to be applied in considering a rule that may arguably fall under the exemptions for "procedural rules" is as stated by *Brown Express*: "[W]hen a proposed regulation of general applicability has a *substantial* impact on the regulated industry, or an important class of the members or the products of that industry, notice and opportunity for comment should first provided." *Brown Express*, 607 F.2d at 702 (citation omitted). The exemption of § 553(b)(A) from the duty to provide notice by publication does not extend to those procedural rules that depart from existing practice and have a substantial impact on those regulated. Our inquiry, therefore, is not whether the rule is "substantive" or "procedural," but rather whether the rule will have a "substantial impact" on those regulated.

We conclude that the Procedure Paper does have a substantial impact on those regulated in the industry. The rule narrowly restricts the discretion of MMS officials in determining the value of NGLP's. It forecloses other valuation methods by prescribing binding valuation criteria. Although the regulation allows the use of posted prices in determining the value of NGLP's, the Procedure Paper

mandates the use of spot prices.[4] Thus, the Procedure Paper does not even comport with the regulation in using posted prices. Moreover, the Procedure Paper eliminates the other four factors in determining the value of NGLP's.

This change in valuation technique dramatically affects the royalty values of all oil and gas leases. Thus, the Procedure Paper should have been published in the *Federal Register* and offered for notice and comment. A party may not be adversely affected by a rule promulgated in violation of these requirements. 5 U.S.C. § 552(a)(1).

III.

We conclude that the Procedure Paper is a substantive rule, and § 553 of the APA controlled its promulgation. We therefore REVERSE the summary judgment and REMAND for such further proceedings as may be necessary.

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[4] A posted price is a publicly announced price at which a purchaser is willing to buy a certain type and amount of petroleum products. Spot prices, on the other hand, reflect actual transactions on a short-term or one-time basis.

APPENDIX C

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

Civil Action No. 3-89-CV-1707-H

(Consolidated with 3-89-CV-2393-H
3-89-CV-2727-H, and 3-89-CV-2751-H)

PHILLIPS PETROLEUM COMPANY,

Plaintiff,

v.

NICK L. KELLY, *ET AL.*

Defendants.

[Filed April 16, 1993]

JUDGMENT

Pursuant to this Court's Memorandum Opinion and Order dated September 18, 1992, the Court hereby orders, adjudges and decrees that the orders and decisions of the Department of the Interior challenged in the above-numbered cases and requiring plaintiffs Atlantic Richfield Company and Phillips Petroleum Company to recompute and pay any unpaid royalties due to the government are valid and enforceable. Specifically, the Court orders as follows:

(1) In *Phillips Petroleum Co. v. Kelly*, No. CA3-89-1707-H, Phillips is hereby ordered to comply with the challenged order dated June 5, 1989. That order requires Phillips to recompute and pay royalties on any proceeds received as Natural Gas Policy Act section 110 (Federal Energy Regulatory Commission Order 94) reimbursements on which royalty had not been paid for the period from July 25, 1980 to June 5, 1989, on all leases which Phillips acquired

from General American Oil Company of Texas. Administrative Record Vol. I, No. 6.

(2) In *Phillips Petroleum Co. v. Kelly*, No. CA3-89-2727-H, Phillips is hereby ordered to comply with the order dated September 26, 1989, by recomputing and paying royalties on any proceeds received as Natural Gas Policy Act section 110 (FERC Order 94) reimbursements on which royalty had not been paid for the period from July 1980 until September 26, 1989, for all leases which Phillips acquired from Aminoil. Administrative Record Vol. II, No. 5.

(3) In *Phillips Petroleum Co. v. Kelly*, No. CA3-89-2751-H, Phillips is hereby ordered to comply with the order dated September 27, 1989, by recomputing and paying royalties on Natural Gas Liquid Products (NGLP) extracted from gas produced from all of its offshore leases for the period from January 1977 through February 1988, except for NGLP extracted at the North Terrebonne gas plant. Administrative Record Vol. III, No. 1.

(4) In *Atlantic Richfield Co. v. Lujan*, No. CA3-89-2393-H, ARCO is hereby ordered to comply with the orders dated September 6 and 7, 1989, by recalculating and paying royalties due on gas produced from Arco's offshore leases and processed through the Yscloskey gas plant and disposed of under non-arms-length arrangements using the Mont Belview, Texas prices prescribed in the Procedure Paper methodology for the sales months October 1983 through February 1988. Administrative Record Vol. VI, Nos. 2 and 3. ARCO is also ordered to comply with the September 29, 1989 order by recomputing and paying additional royalties due for the NGLP extracted from gas produced from all of its Federal offshore leases and disposed of under non-arms-length arrangements using the same methodology for the period from October 1980 through February 1988 (except for gas processed at the Yscloskey gas plant, and limited to the period October 1981 through February 1988 for gas processed

at the Grand Chenier gas plant). Administrative Record Vol. VI, No. 1.

(5) Finally, this Court affirms the decision of the Interior Board of Land Appeals in *Conoco, Inc. and ARCO Oil and Gas Co.*, 110 IBLA 232 (1989), challenged in *Atlantic Richfield Co. v. Lujan*, No. CA3-89-2393-H. Accordingly, the order dated March 31, 1986 and reviewed in that administrative appeal is valid and enforceable. ARCO is hereby ordered to pay additional royalties on NGLP on the basis of the Mont Belview spot price for the period dated January 1980 through April 1983.

IT IS FURTHER ORDERED that the complaints filed in cases numbered CA-3-89-1707-H, CA-3-89-2393-H, CA-3-89-2727-H, and CA-3-89-2751-H are hereby dismissed with prejudice.

IT IS SO ORDERED.

/s/ Barefoot Sanders
United States District Court Judge

DATED: April 16, 1993.

APPENDIX D

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

Civil Action No. 3-89-CV-1707-H
(Consolidated with 3-89-CV-2393-H,
3-89-CV-2727-H, and 3-89-CV-2751-H)

PHILLIPS PETROLEUM COMPANY, Plaintiff,

v.

NICK L. KELLY, *ET AL.* Defendants.

[Filed March 26, 1993]

ORDER

Before the Court are cross-motions for summary judgment on the government's counterclaim: Defendants' Motion for Summary Judgment on the Counterclaim, filed February 1, 1993; the Memorandum of Phillips Petroleum Company ("Phillips") in Response to Defendants' Motion for Summary Judgment on Counterclaim, filed January 25, 1993; and the Opposition of Atlantic Richfield Company ("ARCO"), filed February 25, 1993. Also before the Court are ARCO's Motion for Summary Judgment on Counterclaim, filed December 15, 1992; Phillips' Motion for Summary Judgment on Federal Defendants' Counterclaim, filed February 1, 1993; and Defendants' Response to Plaintiffs' Motions for Summary Judgment on the Counterclaim, filed February 25, 1993.

The Court's September 18, 1992 Memorandum Opinion and Order seems to be the source of some confusion. To clarify, that order ruled that the MMS's orders issued to Phillips and ARCO were valid and enforceable. The Court's

judgment will reflect that the challenged orders will be enforced.

It is important to note that the Court's discussion of the statute of limitations found in 28 U.S.C. §2415 applies only to an "action for money damages." However, no such action is currently pending; the Court's discussion of section 2415 indicates how the Court would treat a claim for money damages if one were to be filed. *See Phillips Petroleum Company v. Kelly, et al.*, No. 3:89-CV-1707-H (N.D. Tex. filed September 18, 1992) at 23 ("[T]he Court concludes that the six year statute of limitations period affords the MMS ample time to investigate, verify, and choose the causes of action that it *will* pursue.") (emphasis added); 51 ("[T]he Government is precluded from bringing any causes of action against Phillips and ARCO based on royalty payments on the leases at issue here more than six years after the payments are due."). Thus, section 2415 has no direct application to the MMS orders. *See S.E.R., Jobs for Progress, Inc. v. United States,* 759 F.2d 1, 5 (Fed Cir. 1985).[1] In its counterclaim, the government asks for an injunction to enforce the Court's September 18, 1992 order. To the extent that the government's counterclaim seeks to enforce the Court's judgment, it is GRANTED.[2] To the extent that the government's counterclaim seeks further relief, it is DENIED without prejudice.

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[1] The Court notes that the Fifth Circuit has questioned a portion of the *S.E.R., Jobs for Progress, Inc.* decision. *See United States v. Popovich,* 820 F.2d 134 (5th Cir.), *cert. denied,* 484 U.S. 976 (1987). However, *Popovich* only addressed the portion of *S.E.R., Jobs for Progress, Inc.* which discussed laches.

[2] The Court notes that it retains the inherent power to enforce its judgments; the Court will do so when and if circumstances require enforcement of the judgment in this case.

The government is DIRECTED to submit by *noon, April 8, 1993* a proposed judgment which provides the remedies spelled out in the Court's September 18, 1992 Memorandum Opinion and Order—*i.e.*, that the IBLA decision and the MMS' orders to recompute and pay any unpaid royalties due to the government are valid and enforceable.

SO ORDERED.

DATED: March 26, 1993.

/s/Barefoot Sanders
Barefoot Sanders, Chief Judge
United States District Court
Northern District of Texas

APPENDIX E

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

Civil Action No. 3-89-CV-1707-H
(Consolidated with 3-89-CV-2393-H,
3-89-CV-2727-H, and 3-89-CV-2751-H)

PHILLIPS PETROLEUM COMPANY, Plaintiff,

v.

NICK L. KELLY, *ET AL.* Defendants.

[Filed March 26, 1993]

ORDER

Before the Court are Atlantic Richfield Company's ("ARCO") Motion for Reconsideration, filed November 6, 1992; Defendants' Memorandum in Opposition, filed December 11, 1992; and ARCO's Reply, filed January 15, 1993.

In the present motion, ARCO asks the Court to reconsider several portions of the September 18, 1992 Order entered in this consolidated case. *See Phillips Petroleum Company v. Kelly, et al.*, No. 3:89-CV-1707-H (N.D. Tex. filed September 18, 1992). However, accepting the government's concessions (i.e. that the September 6 and 7, 1989 orders incorrectly directed ARCO to recalculate NGLP royalties using the Procedure Paper for periods after March 1, 1988, for certain leases and that the MMS has an auditor in residence at ARCO) as well as the government' stipulations, the Court concludes that ARCO's Motion for Reconsideration is DENIED.

SO ORDERED.

DATED: March 26, 1993.

/s/Barefoot Sanders
Barefoot Sanders, Chief Judge
United States District Court
Northern District of Texas

APPENDIX F

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

Civil Action No. 3-89-CV-1707-H
(Consolidated with 3-89-CV-2393-H,
3-89-CV-2727-H, and 3-89-CV-2751-H)

PHILLIPS PETROLEUM COMPANY, Plaintiff,
v.
NICK L. KELLY, *ET AL.* Defendants.

[Filed January 7, 1993]

MEMORANDUM OPINION AND ORDER

Before the Court are Defendants' Motion to Alter or Amend Judgment, filed October 2, 1992; Atlantic Richfield Company's ("ARCO") Memorandum in Opposition, filed October 30, 1992; the Brief of Phillips Petroleum Company ("Phillips") in Opposition, filed November 2, 1992; and Defendants' Reply, filed December 22, 1992.

In the present motion, Defendants[1] request the Court to alter or amend its judgment pursuant to Federal Rule of Civil Procedure 59(e). Phillips and ARCO argue that this motion should be denied solely because a Rule 59(e) motion to alter or amend the judgment is inappropriate at this time, noting that a separate judgment has not been issued pursuant to Fed.R.Civ.P. 58. This contention is without merit. It would be manifestly wasteful to deny Defendant's motion on this ground alone, for the identical motion would be raised again once the Court enters a judgment. Therefore, the Court will

[1] Throughout this Opinion, the terms "government" and "Defendants" will be used interchangeably.

consider Defendants' motion to be a motion to reconsider its September 18, 1992 Memorandum Opinion and Order.

In their motion, Defendants request that the Court "restate its position on a factual matter in the record in order to perfect the decision for any appeal that may be taken." Motion at 1.

On September 18, 1992, the Court enter a Memorandum Opinion and Order in this case, ruling against the government on the statute of limitations issue presented by cross-motions for summary judgment. The Court concluded that the statute of limitations on federal lease royalties begins to run on the date that "the royalties [become] due and payable" and that the running of the statute is not tolled during the pendency of an audit. *See Phillips Petroleum Company v. Kelly, et al.*, No. 3:89-CV-1707-H (N.D. Tex. filed September 18, 1992) at 18, 21. In reaching this conclusion, the Court noted that:

> At one point, the Government suggests that Phillips and ARCO routinely revise their royalty reports and that the statute of limitations should not begin to run until royalty records are complete. There is no evidence that Phillips or ARCO revised their royalty reports or the payments at issue.

Id. at 11 n.10.

Defendants now argue that the record before the Court actually does contain an admission by Phillips that it revises its royalty reports. Defendants claim that in Appendix 21 to Phillips' Brief in Response and Opposition to Defendants' Motion for Partial Summary Judgment ("Phillips' Opposition"), Phillips' affiant Mark Haugland stated that such adjustments are made. In his affidavit, Haugland stated:

> 18. [Phillips] submits amended reports of sales and royalty adjustments as required by the applicable statutes and regulations of the MMS. It does not do so on a "regular" basis as is stated in paragraph 8 of

> the referenced brief [the government's summary judgment brief in the Northern District of Oklahoma]; but, the Company does submit them whenever a requirement to do so prompts the need for an amended filing.

Affidavit of Mark Haugland, submitted as Appendix 21 to Phillips' Opposition at 6. Defendants report that Phillips originally submitted the Haugland affidavit in a similar case filed in the United States District Court for the Northern District of Oklahoma. *See Phillips Petroleum Co. v. Lujan, et al.*, N. 89-C-887-B (N.D. Okla.), consolidated with *ARCO v. Lujan et al.*, No. 89-C-1052-D (N.D. Okla), on appeal, 963 F.2d 1380 (10th Cir. 1992).

Defendants complain that Phillips' brief filed in this Court cites only the language from the Haugland Affidavit which states that Phillips does not submit amended reports of sales and royalty adjustments "on a 'regular' basis" in an attempt to deflect attention from Haugland's statement elsewhere in the same sentence that adjustments are, in fact, made. *See* Phillips' Opposition at 8 n.2. Indeed, in its brief, Phillips indirectly refers to adjustments that are made to sales and royalty reports and argues that these adjustments are often made because of regulatory or statutory requirements. *See id.*

Defendants argue that, no matter how the reports should be characterized, Phillips has admitted that it does submit adjustments. Accordingly, Defendants request that the Court alter footnote 10 of its September 18, 1992 Opinion to reflect that Phillips' affiant, Haugland, has admitted that such adjustments are made.

Defendants explain this factual issue is significant because they have argued that the statutes of limitations cannot begin to run with respect to a payment which is not yet final. Defendants argue that this evidence shows that the responsible government officials do not know, and reasonably

could not know, of facts material to the government's right of action, and that the readjustments can accurately be described as an acknowledgment of a debt which causes a claim to accrue under the applicable statute of limitations.

The Court agrees that footnote 10 of the September 18, 1992 Memorandum Opinion and Order should be altered. Therefore, the Court concludes that footnote 10 be amended to read as follows:

> At one point, the Government suggests that Phillips and ARCO routinely revise their royalty reports and that the statute of limitations should not begin to run until royalty records are complete. There is no evidence that Phillips or ARCO voluntarily revised their royalty reports or the payments at issue. However, the Affidavit of Mark Haugland reveals that Phillips "submits amended reports of sales and royalty adjustments as required by the applicable statutes and regulations of the MMS. It does not do so on a 'regular' basis as is stated in paragraph 8 of the referenced brief; but, the Company does submit them whenever a requirement to do so prompts them need for an amended filing."

Defendants also request that the Court include in the record two voluminous affidavits that contain lists which detail adjustments that have been made to some of the sales and royalty reports of Phillips and ARCO. Specifically, these reports list thousands of adjustments to royalty values and/or sales values or quantities which Phillips and ARCO made during the period after October 1, 1983, for royalty payments originally made and reported for the period before October 1, 1983. Defendants note that these adjustments were submitted many months and years after the original payments and reports, and in some cases, more than six years after the original royalty payment was made. In support of the request to include these reports in the record of this case, Defendants

note that the record in the Northern District of Oklahoma case referred to above contained these reports.

Phillips and ARCO argue that to allow Defendants to include the proffered affidavit would be improper because this evidence was previously available to the parties. Phillips and ARCO note that the computer printouts that Defendants seek to have added to the record were originally available in the first half of 1990, years before the Court issued its September 18, 1992 Opinion. Since Defendants declined to introduce the printouts along with their other summary judgment evidence, Phillips and ARCO reason that Defendants should not be allowed to introduce such evidence now that the Court has ruled against them on the statute of limitations issue.

Defendants counter by noting that they are simply attempting to bring evidence referred to in one of Phillips' briefs to the attention of the Court, claiming that Phillips referred to the adjustments in its Opposition brief. Defendants argue that the Court misapprehended the significance of these adjustments, apparently based on the representations made in Phillips' brief.

The Court concludes that it is inappropriate to allow Defendants to bolster the record long after the Court has ruled on the summary judgment motions. As Phillips and ARCO note, the proper time to introduce summary judgment evidence has passed. The Court declines to accept more evidence at this late date. *See Waltman v. International Paper Co.*, 875 F.2d 468, 474 (5th Cir. 1989).

Finally, Defendants request that the Court alter its judgment to include a consideration of the impact of royalty adjustments on the running of the statute of limitations. Defendants contend that this issue is unresolved because the Court did not acknowledge Phillips' admission that such adjustments are made. Phillips argues that the fact it makes adjustments in the royalties and sales reports does not change the outcome of the Court's decision on the statute of

limitations issue. Phillips argues that the government's claim accrues at the time the contract allegedly is breached (i.e. when royalty payments initially are due), even though the precise amount of damages may not be available until later. It also notes that while adjustments may be made periodically, they are made only because federal statutes or regulations require them to be made.

The Court agrees with Phillips' conclusion that the presence of periodic adjustments does not affect the Court's statute of limitations holding. As discussed at great length in the Court's September 18, 1992 Memorandum Opinion and Order, alleged breaches of the OCS leases "occurred whenever royalties became due and were not fully paid." *Phillips Petroleum Company v. Kelly,* No. 3:89-CV-1707-H (N.D. Tex. filed September 18, 1992) at 13. While periodic adjustments of the amount due may affect the precise amount of damages, the adjustments do not affect the time at which the government's claim accrues and the statute of limitations begins to run. *See id.* at 16 ("The Government had the right to enforce the present causes of action when the royalty payments were due and allegedly underpaid in breach of the OCS leases, even though the precise amount of damages may not have been determined until later."). In the absence of fraud, this conclusion is not altered by the fact that adjustments may be made to the amount of royalties owed, no matter when they are made or for what reason they are made, for the government has the right to bring suit to collect the *total* royalty payment amount due for a specific period when the royalty payment is *first* due and payable. If an audit reveals that more royalties are owed for a specific period, the amount of damages from the breach of the contract to pay royalties increases; no new cause of action is created.

Similarly, the applicable statute of limitations is not tolled because of the presence of any adjustments. As the Court has previously noted, "'[u]ncertainty as to the exact amount of the Government's [damages] does not constitute a lack of

knowledge of a fact "material to the right of action."'" *Id.* at 22 (citation omitted). As noted in the Court's previous opinion, this conclusion indicates that the statute of limitations may not be tolled.

Conclusion

Defendants' motion is GRANTED in part and DENIED in part. Footnote 10 of the Court's September 18, 1992 Memorandum Opinion and Order is amended as indicated above; however, Defendants' request to amend the record to include the affidavits previously filed in the Northern District of Oklahoma is refused.

SO ORDERED.

DATED: January 7, 1993.

/s/Barefoot Sanders
Barefoot Sanders, Chief Judge
United States District Court
Northern District of Texas

APPENDIX G

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

Civil Action No. 3-89-CV-1707-H
(Consolidated with 3-89-CV-2393-H,
3-89-CV-2727-H, and 3-89-CV-2751-H)

PHILLIPS PETROLEUM COMPANY, Plaintiff,

v.

NICK L. KELLY, Area Manager, Dallas Area Compliance Office, Minerals Management Service; BARRY WILLIAMSON, Director, Minerals Management Service of the Department of the Interior; MANUEL LUJAN, JR., Secretary of the Interior; MINERALS MANAGEMENT SERVICE of the United States Department of the Interior; and the UNITED STATES DEPARTMENT OF THE INTERIOR, Defendants.

September 24, 1992

ORDER

Before the Court are Defendants' Motion for Leave To File Amended Answers And Omitted Counterclaims, filed August 28, 1992; Atlantic Richfield's Memorandum in Opposition, filed September 17, 1992; and Phillips' Response in Opposition, filed September 21, 1992.

For the reasons articulated in this Court's Memorandum Opinion and Order in *Phillips Petroleum Company v. Kelly*, No. 3:89-CV-2670-H, filed September 24, 1992, Defendants'

Motion is GRANTED. The counterclaim attached to Defendants' motion will be filed. Furthermore, the counterclaim will relate back to the date of Defendants' answer.

SO ORDERED.

DATED: September 24, 1992.

/s/ Barefoot Sanders
Barefoot Sanders, Chief Judge
United States District Court
Northern District of Texas

APPENDIX H

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

Civil Action No. 3-89-CV-1707-H
(Consolidated with 3-89-CV-2393-H,
3-89-CV-2727-H, and 3-89-CV-2751-H)

PHILLIPS PETROLEUM COMPANY, Plaintiff,

v.

NICK L. KELLY, Area Manager, Dallas Area Compliance Office, Minerals Management Service; BARRY WILLIAMSON, Director, Minerals Management Service of the Department of the Interior; MANUEL LUJAN, JR., Secretary of the Interior; MINERALS MANAGEMENT SERVICE of the United States Department of the Interior; and the UNITED STATES DEPARTMENT OF THE INTERIOR, Defendants.

[Filed September 18, 1992]

MEMORANDUM OPINION AND ORDER

Before the Court are three overlapping motions for summary judgment:

1.) Plaintiff Phillips Petroleum Company's ("Phillips") Motion for Partial Summary Judgment, filed August 16, 1991; Defendants' (collectively, for simplicity purposes, "the Government") Memorandum in Opposition thereto, filed October 18, 1991; Phillips' Supplemental Reply, filed July 9, 1992;

2.) Plaintiff Atlantic Richfield Company's ("ARCO") Motion for Summary Judgment, filed August 16, 1991; the Government's response thereto (contained in its October 18, 1991, Memorandum in Opposition); and ARCO's Reply, filed July 9, 1992;

3.) The Government's Motion for Partial Summary Judgment, filed May 16, 1991; ARCO's Brief in Opposition thereto, filed October 4, 1991; Phillips' Brief in Response and Opposition, filed October 18, 1991; and Defendants' Supplemental Brief, filed July 10, 1992.

Related to these motions are Plaintiffs' Joint Supplemental Brief, filed November 25, 1991; Defendants' Response thereto, filed December 6, 1991; Phillip's Reply, filed December 24, 1991; ARCO's Reply, filed January 6, 1992; and Defendants' Surreply, filed January 15, 1992. Finally, before the Court are Phillips's Brief In Re the One-Year Grace Period Provision of 28 U.S.C. § 2415, filed September 15, 1992; ARCO's Supplemental Brief, filed September 15, 1992; and the Government's Supplemental Brief Regarding One-Year Proviso of 28 U.S.C. 2415, filed September 15, 1992.

I. Background

Phillips and ARCO each produce oil and natural gas throughout the world. Among the leases they hold enabling them to do so are ones located on the outer continental shelf of the United States ("OCS") on lands owned by the federal government. Pursuant to the Outer Continental Shelf Lands Act, the Secretary of the Interior ("the Secretary") is responsible for the management of OCS leases. *See* 43 U.S.C.A. § 1337(a)(1) (West 1986). The Federal Oil and Gas Royalty Management Act ("FOGRMA") authorizes the Secretary to audit, and collect royalties on, these leases. *See* 30 U.S.C.A. § 1711 (West 1986); 30 U.S.C.A. §§ 181, 223-37 (West 1986 & Supp. 1992); *see also* 30 U.S.C.A. §§ 181-

287 (West 1986) (awarding the Secretary, via the Mineral Land Leasing Act, responsibility for mineral lands leases).

Pursuant to these statutory provisions and the terms of the OCS leases at issue in this suit, *see* Affidavit of S. Mark Haugland, filed August 16, 1991, Exhibits A–D, Phillips and ARCO paid monthly royalties to Defendant Minerals Management Service ("MMS"),[1] a division of Defendant Department of the Interior ("DOI"),[2] for the right to extract oil and gas from the leased properties. The MMS carries out its responsibilities through the Royalty Management Program.

Based on audits of sample OCS leases for production between October 1, 1980, and September 30, 1983, the MMS determined that Phillips and ARCO had underpaid royalties on natural gas liquid products ("NGLP's") produced on the OCS leases at issue here and used internally by Phillips and ARCO without being sold.[3] The MMS concluded that, in some cases, the underpayments were the result of Phillips and ARCO undervaluing the gas produced and, in other cases, the result of Phillips failing to pay on reimbursements for production-related costs. In all instances, the MMS determined that the alleged undervaluations were systemic

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[1] Beginning in 1982, the Secretary delegated the administrative responsibility for OCS leases to the MMS. *See* Secretarial order No. 3071 (Jan. 19, 1982), 47 Fed. Reg. 4757 (Feb. 2, 1982).

[2] The remaining Defendants are individual officers of MMS or the DOI sued in their respective capacities as such.

[3] The leases involved are Phillips's No. OCS-G 2712, No. OCSG 2301, No. OCS-G-2302; ARCO's lease No.'s 054-002919-0, 054-002636-0, 054-002637-0, 054-002640-0, and 054-004501-0; and eight leases identified as those acquired through a January 1, 1985, merger of Aminoil, Inc., into Phillips. The MMS approved the Aminoil merger on March 1, 1985, *see* A.R., Vol. II, No. 8, and its royalty calculation efforts were not delayed by it. See A.R. , Vol. III, No.'s 1, 7, 11.

shortcomings, meaning that they recurred with each royalty calculation.

Between June and September 1989, the MMS notified Phillips and ARCO of its determinations and directed both to recalculate royalties due on the OCS leases at issue for the periods in question.[4] *See* Administrative Record ("A.R."), Vol. I, No.'s 5, 6; Vol. II, No. 5; Vol. III, No. 1; Vol. VI, No.'s 1, 2, 3. Phillips and ARCO, disputing the MMS's calculation methods, filed the instant suits, Phillips initiating Civil Action No.'s CA3-89-CV-1707-H, CA3-89-CV-2727-H, and CA3-89-CV-2751-H, and ARCO bringing Civil Action No. CA3-89-CV-2393-H. In their respective actions, Phillips and ARCO seek declaratory judgments that the MMS orders are unlawful and injunctions enjoining Defendants from enforcing the orders in any respect. This Court consolidated the cases because the issues presented in all four overlap significantly. *See* Order of Consolidation, filed March 2, 1990.

Specifically, Phillips and ARCO maintain that, 1.) the statute of limitations codified at Title 28, United States Code, Section 2415(a) ("Section 2415[a]"), bars collection of royalties due and owing more than six years before the respective MMS orders were issued;[5] 2.) the MMS lacks authority to order the recalculations at issue because they amount to self-audits barred by FOGRMA; and 3.) the

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[4] The MMS's orders were given in letters addressed to Phillips's Bartlesville, Oklahoma, office and dated June 5, 1989, June 12, 1989, September 26, 1989, and September 27, 1989, respectively, and letters addressed to ARCO and dated September 6, 7, and 29, 1989, respectively.

[5] The relevant dates for the purposes of Section 2415(a) are the dates on which the Government files complaints, and not the dates of the MMS's orders. *See* 28 U.S.C.A. § 2415(a) (West Supp. 1992); *infra* pp. 9-10. Phillips and ARCO's implied position is that, if the MMS orders fell after the limitations period had expired, then subsequent Government suits would fall likewise, and, hence, be barred.

MMS's valuation procedures were invalid.[6] With respect to the latter issue, two of the consolidated cases[7] involve challenges to the MMS's assessments of reimbursements for production-related costs received based on orders from the Federal Energy Regulatory Commission ("FERC"), and two[8] involve challenges to royalty valuation regulations that were based on the "Procedure Paper on Natural Gas Liquid Products Valuation" ("Procedure Paper"). ARCO also challenges a decision of the Interior Board of Land Appeals ("IBLA") upholding use of the Procedure Paper by the MMS.

Phillips, ARCO, and the Government each move for summary judgment on all issues except the challenges based on the FERC orders. After reviewing the necessary summary judgment tenets, the Court addresses each issue in turn.

II. Summary Judgment

Summary judgment is proper when the pleadings and evidence on file show that no genuine issue exists as to any material fact and that the moving party is entitled to judgment or partial judgment as a matter of law. Fed. R. Civ. P. 56. "Before a court may grant summary judgment, the moving party must demonstrate that it is entitled to judgment as a matter of law because there is no actual dispute as to an essential element of the plaintiff's case." *Christophersen v. Allied-Signal Corp.*, 902 F.2d 362, 364 (1990), *opinion*

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[6] Pivotal too is the parties' agreement that the agency orders at issue in this case are final for the purposes of review by this Court. *See* A.R., Vol. I, No.'s 1, 2; A.R., Vol. II, No.'s 1, 2; A.R., Vol. IV, No. 1; First Joint Status Report, filed October 27, 1989; Defendants' Motion for Partial Summary Judgment at 4, 6, 8; Phillips's Brief in Support of its Cross Motion for Partial Summary Judgment, filed August 16, 1991, at 2.

[7] Cases CA3-89-CV-1707-H and CA3-89-CV-2727-H.

[8] Cases CA3-89-CV-2393-H and CA3-89-CV-2751-H.

superseded on other grounds, 939 F.2d 1106 (1991), *cert. denied*, 112 S. Ct. 1280 (1992).

The Supreme Court has explained that a movant for summary judgment does not bear the burden of negating the nonmoving party's case with evidence; rather, the movant must show only that the opponent's case lacks the evidence it needs to support it. *See Celotex Corp. v. Catrett*, 477 U.S. 317, 324–26 (1986). The Fifth Circuit has held likewise, noting that the moving party is entitled to summary judgment when the motion's opponent fails to make a sufficient showing of proof, *see Skotak v. Tenneco Resins, Inc.*, 953 F.2d 909, 920 (5th Cir. 1992) (quoting *Fontenot v. Upjohn Co.*, 780 F.2d 1190, 1195–98 [5th Cir. 1986]), although the evidence must be viewed in the light most favorable to the motion's opponent. *See Gremillion v. Gulf Coast Catering Co.*, 904 F.2d 290, 292 (5th Cir. 1990); *reh'g denied*, 909 F.2d 1479 (1990).

In sum, "(i)f the record taken as whole could not lead a rational trier of fact to find for the nonmoving party, there is no genuine issue for trial." *Friou v. Phillips Petroleum Co.*, 948 F.2d 972, 974 (5th Cir. 1991) (citing *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 587 [1986]).

III. Statute of Limitations

The Secretary is authorized to "establish a comprehensive inspection, collection and fiscal and production accounting and auditing system to provide the capability to accurately determine oil and gas royalties, interest, fines, penalties, fees, deposits, and other payments owed, *and to collect and account for such amounts in a timely manner.*" 30 U.S.C.A. § 1711(a) (West 1986) (emphasis added). In the present MMS orders, the Government seeks royalties on OCS leases for periods beginning as far back as January 1977, *see* A.R., Vol. III, No. 1, and the Court is now confronted with the issue of how forgiving of delays such as these Congress

intended FOGRMA and Section 2415(a) to be. Phillips and ARCO assert that Section 2415(a) bars recovery of any royalties due and owing more than six years before the MMS orders of June and September 1989. In addition, Phillips argues that the Government is barred from contesting the statute of limitations issue because the same issue was litigated in *Phillips Petroleum Co. v. Lujan*, No. 88-C-1487-E, 1989 WL 239616 (N.D. Okla. October 18, 1989).

Collateral Estoppel

As all parties now note, the decision in that case recently was reversed by the Tenth Circuit in *Phillips Petroleum Company v. Lujan*, 951 F.2d 257, 261 (1991) (*"Phillips I"*). Therein, Phillips sued the same defendants as are present in this case, challenging a September 30, 1988, MMS order requiring it to produce records relating to oil and gas leases for the period October 1, 1980, through September 30, 1983. Phillips, argued, *inter alia*, that the order was barred by a six-year statute of limitations, now codified at Title 28, United States Code, Section 2415. *Id.* at 259. The district court agreed and entered summary judgment in favor of Phillips. *Id.*

In reversing, the Tenth Circuit explained that the statutory provision authorizing the DOI to require lessees to maintain and provide records (30 U.S.C.A. § 1713[a] [West 1986]) was not subject to the statute of limitations. *Id.* at 259–60. To resurrect any meaningful impact from its collateral estoppel argument, Phillips now asks the Court to conclude that *Phillips I* was incorrectly decided and to adopt the district court's statute of limitations reasoning.

The Court finds no applicable reasoning to adopt. The issues in this case are distinct from those of *Phillips I;* at stake here are MMS orders to pay royalties, while *Phillips I*

involved an MMS order to produce documents.[9] The court in *Phillips I* also noted that,

> Defendants were not asserting a claim for underpayment of royalties. Had they been, plaintiff might have very well been able to assert a statute of limitations defense. Rather, defendants were merely ordering plaintiff to provide records. Such an order is well within defendants' authority under the lease agreements and under the pertinent statutes and regulations governing the management of royalty payments.

951 F.2d.at 259-60.

Because there were no audits or royalty valuations at issue in *Phillips I*, the Court concludes that the *dicta* quoted above simply explains when the Section 2415(a) limitations period is generally applicable in FOGRMA royalty cases. This conclusion is supported by the Tenth Circuit's subsequent declaration that, "(i)n *Phillips I*, we clearly held that although § 2415 may provide a legitimate defense to a claim for underpayment of royalties, it does not apply to limit the DOI's right under the FOGRMA to order lessees to maintain and provide records." *Phillips Petroleum Co. v. Lujan*, 963 F.2d 1380, 1386 (1992); *see infra* pp. 26–27.

Sections 2415(a) and 2416

The applicable statute of limitations inquiry begins with Section 2415(a), which provides that,

> (s)ubject to the provisions of section 2416 of this title, and except as otherwise provided by Congress, every action for money damages brought by the United States or an officer or agency thereof which is founded upon any contract express or

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[9] Thus, the collateral estoppel argument is misdirected.

> implied in law or fact, shall be barred *unless the complaint is filed within six years after the right of action accrues* or within one year after final decisions have been rendered in applicable administrative proceedings required by contract or by law, whichever is later . . . .

28 U.S.C.A. § 2415(a) (West Supp. 1992). All parties agree that the six year limitations period governs the present causes of action. *See* Phillips's September 15, 1992 Brief, at 1; ARCO's September 15, 1992 Brief, at 1-2; Defendants' September 15, 1992 Brief, at 1; First Joint Status Report, filed April 9, 1990, at 2. Likewise, it is clear that the period will apply independently to each monthly royalty payment at issue. The questions are when the causes of action accrued and whether the six year period ever tolled subject to the referenced Section 2416.

Section 2416 reads as follows:

> For the purpose of computing the limitations periods established in section 2415, there shall be excluded all periods during which . . . facts material to the right of action are not known and reasonably could not be known by an official of the United States charged with the responsibility to act in the circumstances . . . .

28 U.S.C.A. § 2416 (West 1978).

Phillips and ARCO argue that a cause of action for underpayment of royalties accrues on the date that the royalties were due and that the Section 2415(a) period is tolled only in cases of fraud. The Government would have each cause of action accrue when the MMS completes the

pertinent audit showing that royalties have been underpaid,[10] pointing to a set of Medicare reimbursement cases in support of its position.

In the alternative, the Government argues that it reasonably could not have known that Phillips and ARCO underpaid royalties until the MMS had completed its audits and that the six year limitations period should have been tolled until that point. Noting the MMS's mountainous workload, the Government posits that it is not feasible for the MMS "to review each monthly payment as it is made." Memorandum in Support of Defendants' Motion for Partial Summary Judgment, at 27. Phillips and ARCO counter that such a view allows the Government to complete audits at its discretion because the six year period would not even begin to run until an audit is completed.

Thus, the Government asks the Court to categorically allow all audits to be completed before commencing the limitations period,[11] and Phillips and ARCO ask the Court to categorically require that all audits be completed and actions filed within the limitations period.

The parties' arguments demonstrate that Sections 2415(a) and 2416 blend almost to indistinction in this case. Indeed, the Government's alternate arguments are, in effect, identical. In the Government's script, royalty underpayment causes of

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[10] At one point, the Government suggests that Phillips and ARCO routinely revise their royalty reports and that the statute of limitations should not begin to run until royalty records are complete. There is no evidence that Phillips or ARCO revised their royalty reports or the payments at issue.

[11] All of the audits in this case were completed within six years of the corresponding MMS orders. *See, e.g.*, A.R., Vol. III, No. 11 (documenting that the audit on what originally were Aminoil leases was completed on September 30, 1983); *id.* at No. 1 (evidencing that MMS order was issued on September 27, 1989).

action accrue and are tolled at the same instant—the point when royalties are due.[12]

This merging, however, is no reason to ignore the accrual-tolling distinction inherent in the language of Sections 2415(a) and 2416, a distinction which may well be vital in other royalty cases. The Court's analysis proceeds accordingly.

Accrual of the Causes of Action

"No cause of action generally accrues until the plaintiff has a right to enforce his cause." *United States v. One 1961 Red Chevrolet Impala Sedan*, 457 F.2d 1353, 1358 (5th Cir. 1972) (citations omitted). More to the point with respect to this case, a cause of action based on contract generally accrues at the time of breach. *Pinnacle Port Community Ass'n, Inc. v. Orenstein*, 952 F.2d 375, 377 n.2 (11th Cir. 1992); *United States v. Kass*, 740 F.2d 1493, 1497 (11th Cir. 1984). The alleged breaches in the extant case occurred whenever royalties became due and were not fully paid. *See also United States v. Kass*, 740 F.2d at 1497 (ruling that, for Section 2415[a] purposes, Government's cause of action against doctor for Medicare overcharges accrued when

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[12] The Government relies on *Frey v. Production Co.*, 943 F.2d 578 (5th Cir. 1991), *opinion withdrawn in part on reh'g*, 951 F.2d 67 (5th Cir. 1992). There, the Fifth Circuit construed a Louisiana statute providing that royalty underpayment claims were subject to what was, in effect, a statute of limitations. 943 F.2d at 583. The statute declared that the three year period "commences to run from the day payment is eligible." *Id.* (quoting La. Civ. Code Ann. arts. 3494(5), 3495 [West Supp. 1991]). Despite the statute's plain language, the court concluded that the three year period did not begin to run "until the plaintiff could have known through the exercise of reasonable diligence that they had such a cause of action against Amoco." *Id.* at 587. The court held that payment by the lessee could not create knowledge of an underpayment in the lessor unless an inconsistency was obvious on the face of a royalty payment statement. *Id.* While the statute of limitations issues in *Frey* closely parallel the ones here, *Frey* involved Louisiana law.

overpayments were made); *Foster v. Atlantic Refining Co.*, 329 F.2d 485, 490 (5th Cir. 1964) (determining, in applying Texas law, that the applicable "statute [of limitations] begins to run on money due as royalty under a written contract when such money is due and payable"). Consistent with that conclusion are statutory and regulatory provisions that interest on unpaid royalties accrues beginning on the date that the royalties were due. *See, e.g.*, 30 U.S.C.A. § 1721(a), (f) (West 1986) (authorizing the Secretary to charge interest on underpaid royalties "for the number of days a payment is late"); 30 C.F.R. § 218.54(a) (1987) (declaring that, "[a]n interest charge shall be assessed on unpaid and underpaid amounts from the date the amounts are due"). In this case, there is no reason to conclude that the royalty causes of action accrued at any times other than the times of alleged breach.

The Medicare reimbursement cases, in which the Government sued for Medicare overpayments, while flush with cause of action accrual analyses, are notably distinguishable from the present action. The Medicare Act, 42 U.S.C.A. §§ 1395-95ccc (West 1992 & Supp. 1992), authorizes, in "Part A," hospital benefit for the aged and disabled. The Part A scheme, as constructed at the time, *see* 42 C.F.R. §§ 405.405, 405.06, 405.454, 405.1803 (1983),[13] was specific: First, insurance providers were reimbursed during the year for estimated services. 42 C.F.R. §§ 405.405, 405.454 (1983). Thereafter, as the First Circuit succinctly summarized in *United States v. Hughes House Nursing Home, Inc.*,

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[13] The present version of Section 405.405 can be found at 42 C.F.R. § 413.60 (1991); the present version of Section 405.454 can be found at 42 C.F.R. § 413.64 (1991); and the present version of Section 405.406 can be found at 42 C.F.R. § 413.20 (1991). *See* 51 Fed. Reg. 34790 (Sept. 1986). Section 405.1803, *see* 42 C.F.R. § 1803 (1991), was modified slightly in 1984, *see* 49 Fed. Reg. 322 (Jan. 1984), and again in 1986. *See* 51 Fed. Reg. 34793 (Sept. 1986).

> (a)t the end of each year, the provider is to give (a fiscal) intermediary a statement of its actual costs, 42 C.F.R. § 405406(b); the intermediary will then make an 'initial retroactive adjustment' bringing the money that the provider received in line with its costs as revealed in the statement. 42 C.F.R. § 405.454(f)(2). Subsequently, the intermediary is to audit the cost reports, to determine the 'reasonable cost' of the services. This audit 'constitute(s) the basis' for a *final* 'retroactive adjustment.' 42 C.F.R. § 405.1803(b); *see* 42 U.S.C.§ 1395x(v)(1)(A)(ii).

710 F.2d 891, 893 (1983) (emphasis in original). Consequently, when payments to the insurance provider are made under the Medicare Part A recovery scheme, they are only estimates of amounts due, and, by definition, no cause of action could accrue based on payments that are mere estimates.

Further, the scheme's lock-step progression must be completed before a plaintiff "has a right to enforce his (or her) cause" of action. *United States v. One 1961 Red Chevrolet Impala Sedan*, 457 F.2d at 1358; *see supra* p. 12.[14] As the court stated in *United States v. Gottlieb*,

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[14] For Section 2415(a) purposes, several courts have held that, due to the scheme, the Government's cause of action for Medicare overpayments accrues either when the final audit is completed or when the final retroactive adjustment is made. *See, e.g., United States v. Hughes House Nursing Home, Inc.* 701 F.2d at 894-95 (holding that cause of action accrues when final adjustment is made) ; *United States v. Gravette Manor Homes*, 642 F.2d 231, 234–35 (8th Cir. 1981) (holding likewise); *United States v. Withrow*, 593 F.2d 802, 806 (7th Cir. 1979) (deciding that cause accrues when audit is completed) ; *United States v. Graham*, 471 F. Supp. 123, 125 (S.D. Tex. 1979) (endorsing final adjustment rationale) ; *United States v. Gottlieb*, 424 F. Supp. 417, 420–21 (S.D. Fla. 1976) (similarly endorsing final adjustment rationale).

> under the statutory scheme, no 'final adjustment' is contemplated until 'an audit is made and the final liability of the program is determined.'. . . (N)o suit should be maintained until the final adjustment has been attempted as provided in the regulations. Therefore, until an attempted final adjustment, it cannot be said that plaintiff has a right to enforce his claim.

424 F. Supp. at 420–21 (quoting 20 C.F.R. § 405.454[f][2] [1976]).[15]

No such scheme for royalty recovery is mandated by FOGRMA; that an OCS lease account will be audited at all is guaranteed only "to the extent (it is) practicable" for the Secretary to conduct the audit. 30 U.S.C.A. § 1711(c)(1) (West 1986). Phillips and ARCO's royalty payments must be assumed final for the purposes of Section 2415(a). The Government had the right to enforce the present causes of action when the royalty payments were due and allegedly underpaid in breach of the OCS leases, even though the precise amount of damages may not have been determined until later. *See United States v. Gavilan Joint Community College Dist.*, 849 F.2d 1246, 1249–50 (9th Cir. 1988); *infra* p. 22.

The Government's position is problematic for other reasons. Were the Government's cause of action to accrue when the MMS completed an audit, it would allow the MMS to initiate and complete audits at its leisure, thereby giving it complete control over when the six year limitations period commences. Such unfettered discretion could leave OCS and

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[15] One other case offered by the Government, *United States v. International Assoc. of Firefighters*, 716 F. Supp. 656 (D.D.C. 1989), involving audits in the mineral leasing context, likewise hinges on a specific administrative scheme that dictates when the Government can sue. *See id.* at 657–60.

other lessees open to royalty-based litigation on a given lease for unnumbered years and would eviscerate the limitations period. The purpose of FOGRMA is "to require the development of enforcement practices that ensure the prompt and proper collection and disbursement of oil and gas revenues owed to the United States . . . ." 30 U.S.C.A. § 1711(b)(3) (West 1986). As the Ninth Circuit put it in *United States v. Joint Community College Dist.*, a case in which the Government sued to recover alleged overpayments of tuition and the same basic Section 2415(a) accrual question was at issue, "the Government here essentially asserts that it may postpone litigation indefinitely through delay in conducting its own audit. This is not a tenable position." 849 F.2d at 1249–50.

The Medicare Part A scheme, by contrast, explicitly provides a remedy if the audit and final determinations involved are not timely made. There, a provider who has not received a final determination within twelve months after filing the necessary reports is entitled to a hearing before the Provider Reimbursement Review Board. *See* 42 U.S.C.A. § 1395oo(a)(1) (West 1992); 20 C.F.R. § 405.1835 (1987).

To be sure, the MMS has statutory encouragement to initiate and complete its audits of OCS leases quickly. This, however, is no guarantee of prompt action. The Government, itself, represents that the MMS has taken on a heavy workload, and OCS lessees should not be penalized if it is unable to keep up. In this case, for example, Phillips was not ordered to recalculate certain royalties due for January 1977 until September 1989. *See* A.R., Vol. III, No. 1. The burden of maintaining records and anticipating litigation for uncounted years is not consistent with Section 2415(a), which was "designed to promote diligence by the government in bringing claims to trial and also to make the position of the government more nearly equal to that of a private litigant."

United States v. Kass, 740 F.2d at 1496[16] (citing *United States v. Cardinal*, 452 F. Supp. 542 [D. Vt. 1978] and S. Rep. No. 1328, 89th Cong., 2d Sess., *reprinted in* 1966 U.S.C.C.A.N. 2502).

The Government also argues that "the Interior's acceptance of the monthly royalty payments plainly is not a final determination of the royalty due," citing an IBLA decision[17] in support. Defendant's Memorandum in Opposition at 10 n.6. This view recycles the audit completion argument and would allow the Government to extend the time when each monthly royalty is due until the Government completes its audit. For reasons already discussed, this view is rejected.

The Court concludes that, for Section 2415(a) purposes, causes of action for underpayment of royalties on OCS leases accrue on the dates that the royalties are due and payable.

Tolling the Limitations Period

The Government, in its alternate argument, would have the Court toll the limitations period at the same time that it commenced. Citing the MMS's heavy workload,[18] the Government reasons that, "(t)o audit each one (lease) every

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[16] *Kass* involved Medicare *Part B* overpayment recovery claims. The Medicare Act's Part B scheme affords supplementary medical insurance benefits for the aged and disabled. 740 F.2d at 1494–95. Unlike Part A's very specific lock-step progression, Part B, just like FOGRMA's royalty payment scheme, requires only that payments be accurately and fully accounted for at the time that they are made. *See* 42 U.S.C.A. §§ 1395u(a), (b) (West 1992 & Supp. 1992).

[17] *Cities Service Oil and Gas Corp.*, 113 IBLA 255 (1990).

[18] As of December 31, 1989, the MMS was responsible for some 24,000 federal and Indian oil and gas leases. *See* MMS, Minerals Revenues 1989: Report on Receipts from Federal and Indian Leases 83 (1989).

month to verify the correctness of royalty payments immediately after they are made would require an army of auditors," Defendants' Memorandum in Opposition at 14, and that, without a complete audit, the MMS reasonably could not have known the facts material to any cause of action it might have.

The issue, however, cannot be framed around the MMS's workload and is not a matter of requiring monthly audits of every OCS lease. Indeed, the same reasoning behind the accrual of the Government's causes of action when royalties are due and underpaid prevents the Section 2415(a) limitations period from tolling.

In fact, the support for excluding periods of administrative delay from the Section 2415(a) limitations period is less than overwhelming. Section 2416's legislative history plainly establishes fraud as the driving force behind the "facts. . . not known and reasonably could not have been known" exclusion. The history states that,

> (t)he committee understands that the principal application of this exclusion will probably be in connection with fraud situations. An example would be where the affirmative act of a wrongdoer has served to conceal the fraudulent act. This type of exclusion is to be found in the law of many States in both fraud and tort limitations. The material facts that are not known must go to the very essence of the right of action.

S. Rep. No. 1328, 89th Cong., 2d Sess., *reprinted in* 1966 U.S.C.C.A.N. 2502, 2567-08. In the Eleventh Circuit's words, "[f]oremost in the enactment of § 2416 was the thought that the government should not be penalized if the *fraud* of an adverse party restricted its ability to discover a valid cause of action until long after its accrual." *United States v. Kass*, 740 F.2d at 1497 (emphasis in original). Echoes the Ninth Circuit, "[t]he legislative history expressly

states that the principal application of this exclusion was intended for situations involving fraud." *United States v. Gavilan Joint Community College Dist.*, 849 F.2d at 1249–50; *see also United States v. Batson*, 706 F.2d 657, 676-77 & n.30 (5th Cir. 1983) (referring in *dicta* to the primacy of the fraud rationale).

There is no evidence of fraud in this case.

Still, the same history offers a modicum of support for excluding from the limitations period some delay that can be attributed to the ponderous innerworkings of the Government's administrative agencies. The history includes this charge:

> Paragraph (c) of section 2416 excludes the time when facts material to the right of action are not known and reasonably could not be known by an official of the United States charged with responsibility to act in the circumstances. This provision is required because of the difficulties of Government operations due to the size and complexity of the Government. It is not intended that the application of this exclusion will require the knowledge at the highest level of the Government. Responsibility in such matters may extend down to lower managerial levels within an agency.

S. Rep. No. 1328, 89th Cong., 2d Sess., *reprinted in* 1966 U.S.C.C.A.N. 2502, 2507. The length of delay that Congress intended be excusable under this rationale, however, is unclear. *See also United States v. Kass*, 740 F.2d at 1497 (opining that Congress envisioned "some delay"); *United States v. Incorporated Village of Island Park*, 791 F. Supp. 354, 372 (E.D.N.Y. 1992) (stating that, "[t]here is a reasonable question whether or not Section 2416[c] simply codifies the doctrine of fraudulent concealment").

At the outset, under the Section 2416 administrative delay rationale, there is no summary judgment evidence in this case from which the Court can exclude Section 2416 time periods from the Section 2415(a) limitations period. There is no evidence about the MMS's diligence in pursuing the audits involved and no evidence about the timing of the MMS' knowledge of the alleged underpayments beyond its correspondence to Phillips and ARCO based on the completion of its audits. *See* A.R., Vol. I, No.'s 5, 6; Vol. II, No. 5; Vol. III, No. 1; Vol. VI, No.'s 1, 2, 3 (including references to earlier notices).

The Court also rejects the Government's request to categorically toll the limitations periods regarding the leases at issue until the completion of the pertinent audits. The Court concludes that Section 2416 supports no such administrative delay. At the fore of the Court's consideration is a recurring potential for unfettered MMS discretion in the timing, and diligent pursuit, of its audits. *See supra* pp. 16-18. Because realization of that potential would be grossly unfair to OCS lessees; because any hints of an administrative delay rationale behind Section 2416 are secondary to that regarding fraud; and because the administrative delay rationale more directly runs contrary of the very purpose of Section 2415(a), the Court is of the opinion that the extent to which courts should tolerate such delay is lessened. This position is bolstered by the sense of urgency in FOGRMA, specifically, FOGRMA's goal of "prompt and proper collection and disbursement of oil and gas revenues," 30 U.S.C.A. § 1711(b)(3) (West 1986); *see supra* p. 16, and the Secretary's duty to collect and account for amounts due "in a timely manner." 30 U.S.C.A. § 1711(a) (West 1986); *see supra* p. 7.

As the Eleventh Circuit noted in *United States v. Kass*, the counsel of Section 2416's legislative history is that the "facts material to the right of action" are "the facts making up the "very essence of the right of action." *See* 740 F.2d at

1498 (1984) (relying on S. Rep. No. 1328, 1966 U.S.C.C.A.N. at 2508); *see also United States v. Beck*, 758 F.2d 1553, 1559 (11th Cir. 1985) (following the same standard). In this case, such facts would be those that inform the Government that an OCS lessee has underpaid royalties; the precise amount due need not be ascertained: "Uncertainty as to the exact amount of the Government's . . . (damages) does not constitute lack of knowledge of a fact 'material to the right of action.'" *United States v. Gavilan Joint Community College Dist.*, 849 F.2d at 1249.

Under FOGRMA's scheme, as well as in the case at bar, the Government need not complete its audits to discern the essence of its causes of action. In this case, in particular, there is no dispute that the leases at issue were conventional in the field; that Phillips and ARCO timely paid royalties; and that they timely submitted records to the MMS. Likewise, based on the record and the parties' representations, the audits involved were not problematic. *See, e.g.*, A.R., Vol. III, No. 11 (noting, in audit report, that lessee "was generally doing a good job in reporting and paying its royalties"). There is no evidence of delay on the part of the lessees or impeding complications surrounding the leases." *See, e.g., supra* note 3 (identifying leases at issue and noting that some were acquired through merger approved by the MMS).

The Government's burden seems especially tolerable with respect to Phillips. The MMS has a permanent audit office, manned by four auditors, on cite at Phillips's headquarters in Bartlesville, Oklahoma.[19] *See* Haugland Affidavit at ¶¶ 4-5. That office already conducts audits of Phillips's royalty payments "from time-to-time." *Id.* at ¶ 4.

To be sure, the MMS will need time to ascertain the details germane to any cause of action it might have. But, in

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[19] There is no evidence, one way or the other, regarding an MMS audit office located on site with ARCO.

the absence of summary judgment evidence to the contrary, the Court concludes that the six year limitations period affords the MMS ample time to investigate, verify, and choose the causes of action that it will pursue. As the MMS stated in responding to comments generated in the notice and comment process accompanying the promulgation of the most recent regulation addressing royalty valuation, *see infra* note 23, "MMS realizes that it must become increasingly familiar with transactions occurring in the areas where Federal and Indian leases are situated. By becoming more familiar and obtaining sales volume and price information, MMS will be able to identify anomalies that exist and review the circumstances involved in those transactions." 53 Fed. Reg. 1230 (Jan. 1988).

The Court holds that the Section 2415 six year period did not toll in this case. Holding otherwise would be manifestly unfair to the lessees. Therefore, the statute of limitations bars the Government from bringing any causes of action against Phillips and ARCO based on royalty payments on the leases at issue here that are due and owing for more than six years.[20]

IV. MMS's Authority to Order Royalty Recalculations

The MMS orders notified Phillips and ARCO that they had wrongly calculated royalties on the OCS leases and ordered them to review their calculations and recalculate the royalties due using procedures outlined in the Procedure Paper. *See* A.R., Vol. I, No.'s 5, 6; Vol. II, No. 5; Vol. III, No. 1; Vol. VI, No.'s 1, 2, 3. Phillips and ARCO argue that the MMS has no authority to order such recalculations

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[20] The Court notes that the United States District Court for the Northern District of Oklahoma recently reached similar conclusions regarding virtually identical statute of limitations issues. *See Atlantic Richfield Co. v. Lujan*, No. 89-C-892-B (N.D. Okla. filed September 9, 1992).

because they amount to "self-audits," which are prohibited by FOGRMA. The Government maintains that, when the MMS discovers a systemic error in a lessee's royalty payment procedures, such as the use of wrong royalty formulas, through an audit, the agency has authority to require lessees to review their records, account for royalties due, and make correct royalty payments. Such requirements, says the Government, do not amount to a self-audit.

Section 101 of FOGRMA provides that,

> (t)he Secretary shall audit and reconcile, to the extent practicable, all current and past lease accounts for leases of oil or gas and take appropriate actions to make additional collections or refunds as warranted. The Secretary shall conduct audits and reconciliations of lease accounts in conformity with the business practices and recordkeeping systems which were required of the lessee by the Secretary for the period covered by the audit. . . . The Secretary may also audit accounts and records of selected lessees and operators.

30 U.S.C.A. § 1711(c)(1) (West 1986). Phillips and ARCO suggest that the plain language of this provision dictates that only the Secretary—that is, the DOI, itself—may audit lease accounts, meaning that self-audits are prohibited. The Government counters that no self-audits are involved and that the Secretary is simply taking appropriate collection actions pursuant to Section 101.

The Secretary, through the MMS, already has conducted sample audits in this case, finding what it considered to be systemic errors, and the MMS's orders identify those errors, which serve as the bases for the recalculations ordered.[21]

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[21] This approach is entirely consistent with the legislative history behind Section 101, which states that the section,

As the Government notes, the MMS orders simply require Phillips and ARCO to correct the errors in their royalty calculation formulas already identified and to recalculate royalties based on the correct formulas; Phillips and ARCO are not asked to discover whether the same or any other royalty calculation formulas are in error. Such orders plainly fall within the scope of the Section 101's authorization to "take appropriate actions to make additional collections or refunds as warranted."

Further authority for the orders is found in Section 107 of FOGRMA. It provides that,

> In carrying out his duties under this chapter the Secretary may conduct any investigation or other inquiry necessary and appropriate and may conduct, after notice, any hearing or audit, necessary and appropriate to carrying out his duties under this chapter. In connection with any such hearings, inquiry, investigation, or audit, the Secretary is also authorized where reasonably necessary—
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> (1) to require by special or general order, any person to submit in writing such affidavits and answers to questions as the Secretary may reasonably prescribe, which submission shall be made within

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directs the Secretary to audit and reconcile all lease accounts or accounting line items and to take appropriate actions to make additional collections or refunds as warranted. The Secretary is authorized to select lease or payor accounts for audit on his own initiative—since auditing every account on an annual basis is clearly impractical—but the Committee intends that the Secretary will establish the means whereby all major accounts will be audited, at lease (sic) in whole or in part, annually and other accounts to the extend (sic) that the Secretary determines is sufficient.

H.R. 97-859, 97th Cong. 2d Sess., *reprinted in* 1982 U.S.C.C.A.N. 4268, 4287.

> such reasonable period and under oath or otherwise, as may be necessary. . . .

30 U.S.C.A. § 1717(a) (West 1986). The legislative history behind this provision explains that, "(t)he Committee intended that the Secretary have broad enforcement authority relating to his royalty and lease management functions." H.R. 97-859, 97th Cong. 2d Sess., *reprinted in* 1982 U.S.C.C.A.N. 4268, 4286.

In addition, as the Court already has noted, Congress instructed that the Secretary "ensure the prompt and proper collection and disbursement of oil and gas revenues" with respect to all OCS leases. 30 U.S.C.A. § 1701(b)(3) (West 1986). Requiring the MMS to conduct all royalty calculations needed to correct systemic errors discovered in MMS audits of OCS leases, as the logical extension of Phillips and ARCO's position would have the Court do, would defeat this fundamental FOGRMA purpose in every meaningful respect.

Almost identical self-audit arguments were presented to the Tenth Circuit in *Phillips Petroleum Company v. Lujan*, 963 F.2d 1380 (1992) *("Phillips II")*. There, Phillips and ARCO sought declaratory relief against the same defendants identified in this case, challenging MMS orders requiring Phillips and ARCO to retain oil and gas lease records for the period October 1, 1983, through September 30, 1989, and initiating company-wide audits "of the propriety of the royalty and other payments made by Phillips (and ARCO). . . ." during the same period. *Id.* at 1382. Phillips argued that the company-wide audit would require it to audit its own records once one of its accounting procedures had been deemed erroneous.

The district court rejected this and Phillips and ARCO's other challenges, awarding summary judgment to the defendants. *Id.* at 1383. The Tenth Circuit affirmed, concluding that evidence of the company-wide audit procedures "clearly indicates that the MMS will ask Phillips

and other lessees to make changes to correct repeated royalty underpayments caused by systemic deficiencies" and that, "(s)uch a request falls squarely within the purposes of FOGRMA."[22] *Id.* at 1386.

The recalculations ordered in this case differ in no meaningful respect from those ordered in *Phillips II*. The Tenth Circuit's rationale therein applies with equal force to this case. *See also Amoco Prod. Co.*, 123 IBLA 278, 284-85 (June 18, 1992) (rejecting same self-audit arguments urged by Amoco Production Co.).

There is no genuine issue of fact material to the "self-audit" arguments; that the MMS has authority to order recalculations once a systemic error has been identified is clear.

With the Government's authority to order recalculations of the type at issue herein established, the question becomes whether the recalculations ordered in this case were proper. Thus, the Court turns to Phillips and ARCO's contention that the Government's royalty valuations were invalid.

V. The Government's Royalty Valuations

The authority to determine royalties owed on production from OCS leases rests with the DOI. The royalties due in this case depend on the value assigned to production, and the Director of the MMS is responsible for determining that

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[22] Phillips and ARCO also presented in *Phillips II* the same statute of limitations arguments they urge herein. Relying on its opinion in *Phillips I*, the Tenth Circuit rejected those arguments with respect to the MMS's order to retain records. *See* 963 F.2d at 1386. The court did not reach the statute of limitations arguments as they concerned the order initiating audit procedures.

value.[23] *See* 30 C.F.R. § 206.150 (1987). Contrary to ARCO's assertions, there is no burden on the MMS to determine that the lessee's valuations are unfair or unreasonable before imposing its valuations on the lessee. *See Mesa Operating Ltd. Partnership v. United States Dept. of the Interior*, 931 F.2d 318, 323 (5th Cir. 1991), *cert. denied*, 112 S. Ct. 934 (1992); *see also* 30 C.F.R. § 206.150 (1987) (outlining Secretary of the Interior's valuation authority).

The valuations at issue here were governed by DOI regulation "Section 206.150"[24] which, at the time of the MMS orders, read as follows:

> The value of production shall never be less than the fair market value. The value used in the computation of royalty shall be determined by the Director. In establishing the value, the Director shall consider: (a) the highest price paid for a part or for a majority of like-quality products produced from the field or area; (b) the price received by the lessee; (c) posted prices; (d) regulated prices; and (e) other relevant matters. Under no circumstances shall the value of production be less than the gross proceeds accruing to the lessee from the disposition of the produced substances or less than the value computed on the reasonable unit value established by the Secretary.

30 C.F.R. § 206.150 (1987). In this case, the MMS cited Section 206.150 when ordering Phillips and ARCO to

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[23] The leases at issue in this case, with the exception of the Phillips's "section 6" lease, echo the DOI's right to calculate production value. *See* Haugland Affidavit at Exhibits A, B, C. The section 6 lease is silent on the issue. *See id.* at Exhibit D. That silence, however, does not impede the DOI's express regulatory authority.

[24] The MMS has since revised its gas royalty valuation regulations. The latest version, 30 C.F.R. § 206.153 (1991), became effective March 1, 1988. *See* 53 Fed. Reg. 1230 (1988).

recalculate royalties. In addition, the MMS orders looked to the Procedure Paper, a document issued by the Royalty Valuation and Standards Division of the Royalty Compliance Division of the MMS on December 14, 1984, modified by the MMS on February 25, 1985, and modified by the IBLA in *Conoco, Inc., and ARCO Oil and Gas Co.*, 110 IBLA 232 (August 29, 1989) *("Conoco")*. The Procedure Paper purports to set forth a "yardstick valuation technique" to assist applications of Section 206.150. A.R., Vol. IV, No. 19, Attachment 1, unnumbered p. 2.

Phillips and ARCO now argue that one guideline set forth in the Procedure Paper, summarized by Phillips as "the published spot price in a particular commercial bulletin for a particular location," Phillips's Brief in Response at 16, became the MMS's sole consideration in valuing production, and hence, that the MMS failed to properly consider all of the valuation factors set forth in Section 206.150. Further, the MMS's use of the Procedure Paper, say Phillips and ARCO, amounted to rulemaking in violation of the notice and comment requirements of the Administrative Procedure Act ("APA"), 5 U.S.C.A. §§ 551-59 (West 1977 & Supp. 1992). In addition, to the extent that it approves the Procedure Paper, ARCO asks this Court to set aside the IBLA's *Conoco* decision.

In the alternative, Phillips and ARCO contend that the DOI failed to publish the Procedure Paper in the *Federal Register* pursuant to the APA's requirement that all substantive rules of general applicability and statements of general policy be so published, and that the application of the paper in this case violated other prohibitions against retroactive agency action.

Phillips and ARCO's first set of arguments boils down to two issues: a.) the validity of the MMS's production valuations; and b.) the impact of the APA's rulemaking

requirements on the Procedure Paper. Because the second issue affects the first, the Court begins its inquiry there.

Notice and Comment Rulemaking and the Procedure Paper

Section 553[25] of the APA requires that an agency promulgating a rule afford the public opportunity to have input into the rulemaking process by giving general notice of the proposed rule in the *Federal Register* and providing interested persons a chance to comment on the rule. *See* 5 U.S.C.A. § 553(b), (c), (d) (West 1977); *Batterton v. Marshall,* 648 F.2d 694, 711 (D.C. Cir. 1980). In this case, it is undisputed that these procedures were not followed; the Government argues simply that the Procedure Paper does not constitute a rule for APA purposes, and, therefore, is not subject to the APA's rulemaking requirements.

The APA defines a rule as,

> the whole or a part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or proscribe law or policy or describing the organization, procedure, or practice requirements of an agency and includes the approval or prescription for the future of rates, wages, corporate or financial structures or reorganizations thereof, prices, facilities, appliances, services, or allowances therefor *or of valuations, costs, or accounting, or practices bearing on any of the foregoing*. . . .

5 U.S.C.A. § 551(4) (West 1977) (emphasis added). Whether an agency's promulgation constitutes a rule is a matter of the item's substance and not the label given to it by the agency. *United States Dep't of Labor v. Kast Metals Corp.*, 744 F.2d 1145, 1149 (5th Cir. 1984) (citations omitted).

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[25] Meaning the section number as codified in Title 5 of the United States Code.

Consequently, for the purposes of this case, the Procedure Paper's "yardstick" terminology, by itself, has no effect. Rather, what is significant is that the Procedure Paper directly influences the valuation of NGLP's; whether it contains simple guidelines, descriptions, procedures, or binding dictates, the Procedure Paper qualifies as a rule under the APA's general definition.

That is not to say, however, that the paper is subject to the APA's notice and comment requirements. Indeed, exempted from those requirements are "interpretative rules, general statements of policy, or rules of agency organization, procedure, or practice." 5 U.S.C.A. § 553(b)(A) (West 1977).

The Procedure Paper, on its face, appears to fall under this exemption as either interpretive or procedural.[26] Courts have characterized those rules that merit notice and comment procedures as "substantive" rules, *see American Trucking Ass'n, Inc. v. United States*, 688 F.2d 1337, 1351 (11th Cir. 1982), *rev'd on other grounds*, 467 U.S. 354 (1984), and the distinction between substantive and interpretive rules beckons the Court here.

The distinction was a genesis of *Conoco*, a case in which ARCO and Conoco, Inc., challenged the Procedure Paper with the same arguments presented here. There, the IBLA concluded that the paper was not a substantive rule subject to the APA's notice and comment requirements, reasoning as follows:

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[26] The distinction between interpretive and procedural rules has not been a burning issue for the courts. *See American Trucking Ass'n, Inc, v. United States*, 688 F.2d at 1351 (noting the difference and crediting the Fifth Circuit's *Brown Express, Inc. v. United States*, 607 F.2d 695, 702 [1979]); *see also Jean v. Nelson*, 711 F.2d 1455, 1479 (11th Cir. 1983) (summarizing *American Trucking), rev'd in part on other grounds*, 727 F.2d 957 (1984), *aff'd*, 472 U.S. 846 (1985).

> Substantive rules have the force of law where they constitute a substantive modification of an existing regulation, adoption of a new regulation, or a change in policy. The Procedure Paper merely clarified the existing regulations by setting forth a yardstick by which MMS would measure the reasonableness of royalty values reported by lessees. It did not require lessees to value their production by any specific method, nor did it modify any existing regulation. Rather, it found that, after consideration of the reasonable value of NGLP (natural gas liquid product) in situations where no arm's-length contract existed was the commercially available spot price bulletins. We find the Procedure Paper to be essentially a policy guideline adopted by MMS to assist in valuing NGLP production for royalty purposes under the provisions of the relevant regulation. As such, it does not have the force and effect of law as a duly promulgated regulation does, and the Board will decline to follow it where it is inconsistent with the terms of the relevant regulations.

110 IBLA at 242–43, A.R., Vol. IV, No. 1 (citations omitted). During its assessments of the valuations at issue in *Conoco*, the IBLA modified the Procedure Paper in one respect, stating that "we are unable to affirm the application of the Procedure Paper to the extent it is used to value NGLP production at a price in excess of the fair market value floor price. . . ." *Id.* at 244.

This Court may set aside the MMS's orders or the IBLA's determination to the extent that they or it wrongly apply the Procedure Paper if the Court finds that the any of the actions were "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C.A. § 706(2) (West 1977). The Court "must consider whether the (agency's) decision was based on a consideration

of relevant factors and whether there has been a clear error of judgment." *Citizens to Preserve Overton Park, Inc. v. Volne*, 401 U.S. 402, 416 (1971); *see Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843-45 (1984). Put another way, the Court may reject the orders or the determination "only if the agency's interpretation is *impermissible* or *unreasonable*." *Mesa Operating, Ltd. Partnership v. United States Dept. of the Interior*, 931 F.2d at 323 (emphasis in original). Significantly, "(t)his standard is even more deferential where . . . a Court is reviewing an agency's application and interpretation of its own regulations." *Citizens for Fair Util. Regulations v. United States Nuclear Regulatory Comm'n*, 898 F.2d 51, 54 (5th Cir.) (citing *Robertson v. Methow Valley Citizens Council*, 490 U.S. 332 [1989]), *cert. denied*, 111 S. Ct. 246 (1990); *see Udall v. Tallman*, 380 U.S. 1, 16–17 (1965).

With this standard in mind, the Court conducts its substantive/interpretive rule analysis. Whether a rule is substantive or interpretive is a question of law for the Court. *Trinity Indus., Inc. v. Dole*, 760 F. Supp. 1194, 1198 (N.D. Tex. 1991) (Belew, J.) (citing *Reeder v. FCC*, 865 F.2d 1298 [D.C. Cir. 1989]), *vacated on other grounds*, 963 F.2d 795 (5th Cir. 1992).

Substantive rules are "those that '*effect a change* in existing law or policy,'" *Mount Diablo Hosp. Dist. v. Bowen*, 860 F.2d 951, 956 (9th Cir. 1988) (emphasis in original), that is, those that are binding, *Western Coal Traffic League v. United States*, 694 F.2d 378, 392 (5th Cir. 1982), *cert. denied*, 466 U.S. 953 (1984), or have the force of law. *Ohio Dep't of Human Servs. v. United States Dep't of Human Servs., Health Care Financing Admin.*, 862 F.2d 1228, 1233 (6th Cir. 1988). An interpretive rule, undefined in the APA, is "merely a clarification or explanation of an existing statute or rule." *Id.* (quoting *Guardian Fed. Sav. & Loan Ass'n v. Federal Sav. & loan Ins. Corp.*, 589 F.2d 658, 664 [D.C.

Cir. 1978]). Interpretive rules "are not determinative of issues or rights addressed", and "do not. . . foreclose alternate courses of action or conclusively affect rights of private parties." *Batterton v. Marshall*, 648 F.2d 694, 702 (D.C. Cir. 1980).[27]

The District of Columbia Circuit provided this oft repeated insight:

> Generally speaking, it seems to be established that 'regulations,' 'substantive rules' or 'legislative rules' are those which create law, usually implementary to an existing law; whereas interpretative rules are statements as to what the administrative officer thinks the statute or regulation means.

Cabais v. Egger, 690 F.2d 234, 238 (1983) (quoting *Gibson Wine Co. v. Snyder*, 194 F.2d 329, 331 [D.C. Cir. 1952]); *see Brown Express, Inc. v. United States*, 607 F.2d at 701 (quoting the same language with approval); *Rivera v. Becerra*, 714 F.2d 887, 890–91 (9th Cir. 1983) (endorsing the *Cabais v. Egger* view), *cert. denied*, 465 U.S. 1099 (1984).[28]

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[27] The District of Columbia Circuit announced these conclusions with respect to all of the non-binding actions specified in 5 U.S.C.A. §§ 553(b)(3)(A), (d)(2) (West 1977). *See* 648 F.2d at 701. Therefore, the conclusions apply to each such action, individually. *See id.* at 701–02.

[28] Other definitional commentary is available. For example, in the words of the 1947 Attorney General's Manual on the APA, as quoted by the Fifth Circuit, interpretive rules are "'rules or statements issued by an agency to advise the public of the agency's construction of the statutes and rules which it administers.'" *Brown Express, Inc. v. United States*, 607 F.2d at 700. Similarly, the Ninth Circuit has presented this view:

> In determining whether a rule is interpretive or substantive, two factors must be considered. The first factor is whether the rule modifies existing rights, law, or policy. If the

Whether a rule is substantive or interpretive is a matter of its substance and application; labels or phraseology used in the rule's text are not dispositive, and can be misleading. *See United States Dep't of Labor v. Kast Metals Corp.*, 744 F.2d at 1149; *American Trucking Ass'ns, Inc. v. I.C.C.*, 659 F.2d at 463; *Pharmaceutical Mfrs Ass'n v. Finch*, 307 F. Supp. 858, 863 (D. Del. 1970). Therefore, for resolution in the present case, the Court looks to both the substance, and the application, of the Procedure Paper.

The substance of the Procedure Paper is instructive. To begin, the paper explains its purpose as follows:

> Recent reviews of gas plants by the Royalty Compliance Division and the Office of Inspector General have raised questions regarding the appropriate method of valuing natural gas liquid products (NGLP's) extracted from gas produced on Federal and/or Indian lands. This valuation problem is particularly prevalent in cases where NGLP's have been transferred internally between affiliated entities.
>
> MMS regulations require the Secretary to establish a basis for computing royalties using a reasonable unit value. *This value should never be less than the fair market value as determined by*

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rule 'effect(s) a change in existing law or policy,' or '"affect(s) individual rights and obligations,"' the rule is substantive. If the rule is only indicative of the agency's interpretation of existing law or policy, it, is interpretive.

Second, the source of the rule must be considered. If it is promulgated pursuant to statutory authority, it is a substantive rule. If the agency does not exercise delegated legislative power to promulgate the rule, it is interpretive.

W.C. v. Bowen, 807 F.2d 1502, 1504 (1987) (citations omitted), *opinion amended and reh'd denied*, 819 F.2d 237 (1987).

> *guidelines established by the Secretary.* At a minimum, royalties must be paid on the gross proceeds accruing to the lessee.
>
> *The purpose of this paper is to develop a 'yardstick' valuation technique for determining the reasonableness of a lessee's NGLP Prices.*

A.R., Vol. IV, No. 19, Attachment 1, unnumbered p. 2 (footnote omitted, emphasis added).

> The Procedure Paper further states that,
>
> in an effort to develop a yardstick. . . *the following sources were considered:*
>
> - *NGLP sales contracts*
> - *Prices received by lessees*
> - *Table 7 (DOE) prices*
> - *Commercially available NGLP Bulletins*
>
> *A study of these sources* concluded that commercial price bulletins represent the best available price source and in most instances are indicative of NGLP fair market value.

Id. at unnumbered p. 4 (emphasis added).

The foregoing provisions are dispositive. They establish that the Procedure Paper is governed by Section 206.150 and that the paper's guidelines are driven by the regulation's core dictate that production value should never be less than fair market value. Further, while Phillips and ARCO contend that Section 206.150 requires the MMS to consider all five of the valuation factors set forth in its text, and the Court agrees, 30 C.F.R. § 206.150 (1987) (providing that, "[i]n establishing the value, the *Director, shall consider.* . . . ") (emphasis added), the paper documents that the MMS has considered these factors in the form of NGLP sales contracts, prices

received by lessees, Table 7 (DOE) prices, and commercially available NGLP bulletins. Moreover, while all five valuation factors need to be considered, it is inevitable that one factor ultimately may carry more weight than the others. The paper simply concludes that, after considering all five factors, one is more indicative of fair market value than the others.

The paper continues:

> To establish a yardstick to compare to the lessee's reported prices, MMS will take the highest and lowest published prices for the month from the appropriate bulletin. If the reported price falls within this range, the value will normally be accepted by MMS for royalty determination purposes. . . . If the prices used to calculate royalties fall below this range, a minimum value that is acceptable to MMS can be determined by developing an average value from the lowest and highest prices in the range.

Id. at unnumbered pp. 4-5.

This provision and others that follow document that the price received by the lessee is considered and receives a great deal of deference in the paper's recommendations. The paper also includes a Table of Price Sources that offers "suggested locations" for obtaining NGLP price sources for different producing areas in the United States, stressing with respect to those locations that, "each valuation case should be separately evaluated to determine if an alternate location would be more pertinent than the suggested location." *Id.* at Procedure Paper Attachment 1 (unnumbered p. 10). In effect, the paper creates a list of sources to be consulted for "spot prices," which are equivalent to the Section 206.150 valuation factor, "posted prices."[29] The location variable is just one of the paper's

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[29] The Court accepts the Government's representation that a spot price is a type of posted price, and the Procedure Paper seems to indicate the same.

several indications that Section 206.150's "other relevant factors" were not ignored.

In addition, that the paper interprets Section 206.150's fair market value is evidenced in its distinction between arm's-length and non-arm's-length contract situations. The pertinent portion of the paper reads as follows:

(a) Arm's-length contracts

(From January 1980 to present)

If lessees have a true arm's length contract which establishes an NGLP price, MMS will normally accept the arm's length contract price for royalty purposes unless the gross proceeds received were higher than the contract price. For computation purposes, MMS will accept the greater of the arm's length contract price or gross proceeds.

(From 1973 to January 1980)

If the lessee received a maximum permissible price under the DOE regulations which was less than the contract price, the maximum permissible price becomes the fair market value to use for royalty computation purposes. Otherwise, contract prices or gross proceeds are considered fair market value.

(b) Non-arm's-length contracts/No contract

(From January 1980 to present)

If lessees have a non-arm's-length contract which establishes an NGLP price *and* the lessee can demonstrate that the contract has characteristics similar to arm's-length contracts which represent fair market value, MMS will accept the non-arm's-length contract price for royalty computation purposes. If there are no arm's-length contracts for the same field or area, or the non-arm's-length contract does not represent fair market value, the yardstick value is considered fair market value.

(From 1973 to January 1990)

If the lessee received a maximum permissible price under the DOE regulations which was less than the yardstick price, the maximum permissible price becomes the fair market value to use for royalty computation purposes. Otherwise, yardstick prices or gross proceeds are considered fair market value.

A.R., Vol. III, No. I (emphasis in original).

From beginning to end, the Procedure Paper strives to explain what generally constitutes "fair market value" in certain circumstances; it falls well short of effecting a change in existing law or policy. Based on the manner in which the paper sets valuation ranges, recommends location variables, and accounts for contract-based considerations, the paper truly functions as a "yardstick"; it cannot be said to have the force of law.

The MMS's application of the Procedure Paper in the present case was likewise consistent with the paper's interpretive substance. With respect to each lease to which the Procedure Paper was applied, *see supra* p. 4 n.5, the MMS determined that Phillips and ARCO had failed to value production at fair market value and plainly documented that Section 206.150 was the source of its rulings. *See* A.R., Vol. III, No. 1; Vol. VI, No.'s 1, 2, 3. Based on that determination, the MMS ordered Phillips to recalculate royalties, repeating the Procedure Paper's yardstick guidelines as follows:

For determining the reasonableness of NGLP values based on non-arm's-length transactions, the MMS policy is to apply procedures as set out in its Procedure Paper, as modified by *Conoco Inc., ARCO Oil and Gas Co.*, 110 IBLA 232 (1989). The Procedure Paper now provides that if the NGLP's were disposed under non-arm's-length transactions, including transfers to affiliates, the unit values will

> be compared to the lowest prices published in commercial bulletins. If the value falls below the low price, it is considered unreasonable and unacceptable, and a value using the low price is used. Such values will be used for deriving a manufacturing allowance *and* for calculating royalties.

A.R., Vol. III, No. 1 (emphasis in original). The letter to ARCO likewise stated that, "(f)or determining the reasonableness of NGLP values for non-arm's-length arrangements, the MMS policy is to apply procedures as set out in the NGLP Paper as modified in IBLA decision 87-762, 88-56, decided August 29, 1989." A.R., Vol VI, No. 1 (emphasis added). In considering the leases at issue in each case, the MMS concluded, pursuant to the Procedure Paper, that spot market prices were a reasonable indicator of value and assessed royalties based on the Mont Belvieu, Texas, spot price. *See id.*; A.R., Vol. III, No. 1.

These orders demonstrate that the Procedure Paper was applied as a vehicle to aid assessments of Section 206.150's fair market value; as with the substance of the paper, its application does not effect a change in Section.206.150 or other existing law or policy. Additionally, the fact that the MMS uses the yardstick price ranges recommended in the paper does not make the paper, itself, binding.

Alternatively, the Court considers the Procedure Paper as a procedural rule under the APA.[30] The test in the Fifth

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[30] Under the APA, there is no definition of procedural rules. In the context of its substantial impact test, the Fifth Circuit noted only that "procedure" is the opposite of "substance." *Brown Express, Inc. v. United States*, 807 F.2d at 701. Black's Law Dictionary defines "procedure" as "the mode of proceeding by which a legal right by which a legal right is enforced, as distinguished from the substantive law which gives or defines the right, and which, by means of the proceeding, the court is to administer; the machinery, as distinguished from its product. That which

Circuit for the APA's procedural rule exemption is as follows: The exemption does not apply to any proposed regulation that departs from existing practice and has a "substantial impact" on a "regulated industry, or an important class of members or the products of that industry." *Brown Express, Inc. v. United States*, 607 F.2d at 702 (quoting *Pharmaceutical Mfrs Ass'n v. Finch*, 307 F. Supp. 858, 863 [D. Del. 1970]); *see also United States Dep't of Labor v. Kast Metals Corp.*, 744 F.2d at 1156 (discussing "the twin prongs of departure and substantial impact"). As the Fifth Circuit later explained,

> (i)n essence, the substantial impact test is the primary means by which courts look beyond the label 'procedural' to determine whether a rule is of the type Congress thought appropriate for public participation. An agency rule that modifies substantive rights and interests can only be nominally procedural, and the exemption for such rules of agency procedure cannot apply.

United States Dep't of Labor v. Kast Metals Corp., 744 F.2d at 1153 (citations and footnote omitted).[31]

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regulates the formal steps in an action or other judicial proceeding. . . ." Black's Law Dictionary 1083 (5th ed. 1987). Beyond these basic principles, the Court sees no reason to attempt a rigid distinction between procedural and interpretive rules under the APA. Indeed, in most cases, courts have failed to acknowledge distinctions among the APA Section 553(b) (A) exemptions. *See American Trucking Ass'n, Inc. v. United States*, 688 F.2d at 1351; *supra* note 26.

[31] Although the substantial impact test has been criticized elsewhere, *see, e.g., American Transfer & Storage Co. v. Interstate Commerce Comm'n*, 719 F.2d 1283, 1285 n.4 (5th Cir. 1983) (summarizing criticisms of the test); *United States Dep't of Labor v. Kast Metals Corp.*, 744 F.2d at 1154 n. 19 (rejecting the Ninth Circuit's criticisms of the test and noting that the District of Columbia Circuit, while also criticizing it, employs the test), it remains the standard in the Fifth Circuit.

In the present case, the Court already has held that the Procedure Paper departs not from the existing Section 206.150 practice.[32] *See supra* pp. 36–41. Additionally, there is no evidence that the paper has had a substantial impact on the OCS lease market and OCS lessees; Section 206.150's fair market value has been controlling production valuations all along, and the paper simply clarifies its meaning. In the parlance of the Fifth Circuit, any substantial impact of the paper is "purely derivative." *United States Dep't of Labor v. Kast Metals Corp.*, 744 F.2d at 1156.[33]

The Court concludes that the IBLA did not abuse its discretion, as outlined in the APA, 5 U.S.C.A. § 706(2) (West 1977), when it determined that the Procedure Paper was an interpretive rule not subject to the APA's notice and comment requirements in *Conoco, Inc., and ARCO Oil and Gas Co.*, 110 IBLA 232 (August 29, 1989). The IBLA's determination was not unreasonable, *see Mesa Operating, Ltd. Partnership v. United States Dep't of the Interior*, 931 F.2d at 323, by either of two independent analyses: The paper is interpretive in substance and application, and, in light of its consistent obedience to Section 206.150, the paper, itself, is not the source of any substantial impact on the OCS leasing industry and OCS lessees.

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[32] The Court, of course, understands that this practice necessarily must be shrinking because Section 206.150, per se, has been superseded by the March 1, 1988 production valuation regulations. *See* 30 C.F.R. § 206.153 (1991); *supra* note 24.

[33] Phillips also posits that the MMS's failure to give it notice of "the new standard for computing royalties on NGLP's set forth in the Procedure Paper," Phillips's Brief in Support of its Cross-Motion for Partial Summary Judgment at 52, violated Phillips's substantive and procedural due process rights. This argument fails because it is contingent on the existence of a right to notice and opportunity to comment in some form. Phillips has failed to establish such a right. Any rights that Phillips did have were satisfied when the MMS followed Section 206.150.

The Procedure Paper was not subject to the APA's notice and comment rulemaking requirements. There is no genuine issue of material fact to the contrary.

Section 552[34] *of the APA*

Phillips's next contention is that the Procedure Paper should have been published in the *Federal Register* pursuant to Section 552 of the APA.

Apart from the APA's notice and comment requirements, Section 552 commands that an agency publish in the *Federal Register* "substantive rules of general applicability adopted as authorized by law, and statements of general policy or interpretations of general applicability formulated and adopted by the agency." 5 U.S.C.A. § 552 (West 1977). It further provides that, "(e)xcept to the extent that a person has actual and timely notice of the terms thereof, a person may not in any manner be required to resort to, or be adversely affected by, a matter required to be published in the Federal Register and not so published." *Id.* In other words, the Section 552 "requirement for publication attaches only to matters which if not published would adversely affect a member of the public." *United States v. Goodman*, 605 F.2d 870, 887-88 (5th Cir. 1979) (quoting *Hogg v. United States*, 428 F.2d 274, 280 [6th Cir. 1970], *cert. denied*, 401 U.S. 910 [1971]). It is undisputed that Phillips (and ARCO) had no actual notice of the Procedure Paper until it was applied in this case.

The Court already has held that the Procedure Paper is not a substantive rule for Section 553's notice and comment rulemaking purposes, and that holding applies with equal force under Section 552. *See Brecker v. Queens B'Nai B'Rith Housing Dev. Fund Co.*, 798 F.2d 52, 56-57 (2d Cir. 1986); *McKenzie v. Bowen*, 787 F.2d 1216, 1222-23 (8th Cir. 1986).

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[34] Meaning the section number as codified in Title 5 of the United States Code. *See also supra* note 23.

Therefore, the paper does not have the type of effect on the public contemplated by Section 552. Allowing Section 552's requirements to kick in for anything less than a substantive rule would require publication of a potentially limitless list of agency procedures, statements, and actions.

Courts have recognized this limit. In *Chevron Oil Co. v. Andrus*, 588 F.2d 1383 (5th Cir.), *reh'g denied*, 591 F.2d 1343, *cert. denied*, 444 U.S. 879 (1979), for example, a regional manager in the Bureau of Land Management of the DOI accepted Chevron's bids on some oil leases. Later, however, the Deputy Under Secretary of the Interior rejected the bids. *Id.* at 1384. The DOI claimed that it was not bound by the regional manager's acceptance because, in part, of a provision in its internal manual that provided that, "'(a)n officer who delegates or redelegates authority does not divest himself of the power to exercise that authority.'" *Id.* at 1388 (quoting 200 Departmental Manual § 1.3 [1970]). The manual had not been published in the *Federal Register*.

The Fifth Circuit ruled that the Manual's provision was binding and afforded the Under Secretary authority to overrule the regional manager. *Id.* at 1388-89. The court reasoned that,

> it has been held that (Section 552's) 'requirement for publication attaches only to matters which if not published would adversely affect a member of the public,' or which affect the steps a party must take to present a matter to an agency. The provision in the Interior's manual does not relate to the manner in which bids must be submitted. Nor was Chevron adversely affected by its nonpublication. We do not believe that knowing that the Secretary could participate in a decision to reject a bid would have induced Chevron to bid more than it did, and only a higher bid would have influenced the Deputy Under Secretary's decision.

Id. at 1388 n. 8 (quoting *Hogg v. United States*, 428 F.2d at 280) (citation omitted). Similarly, in *Hogg v. United* States, the Sixth Circuit held that, "the Administrative Procedure Act does not require that all internal delegations of authority from the Attorney General must be published in order to be effective." 428 F.2d at 280.

In *McKenzie v. Bowen*, the Secretary of Health and Human Services promulgated a method for calculating retroactive social security disability benefits in a program manual but did not publish the method in the *Federal Register*. 787 F.2d at 1217, 1220. Consequently, the district court enjoined the secretary from calculating benefits pursuant to the program manual method. The Eighth Circuit reversed, ruling that the method need not be published in the *Federal Register* because it was interpretive, rather than substantive.[35] *Id.* at 122-23.

In this case, the impact on royalties felt by Phillips (and ARCO) has been caused by the royalty valuation regulation, itself, Section 206.150, and not by the Procedure Paper's interpretation of it. Furthermore, the Procedure Paper does not change the "steps a party must take to present a matter to an agency." *Chevron Oil Co. v. Andrus*, 588 F.2d at 1388 n.8; *see supra* p. 46.

Though not pertinent for Section 552 purposes, at first blush, it appears that notice of the paper may have influenced Phillips's royalty calculations. If this were true to any meaningful extent, however, Phillips would not be pursuing the present consolidated cases. Phillips's only alternatives to the royalties assessed against it by the MMS are the royalties it actually paid. Those, of course, were considered by the

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[35] As a second rationale for the injunction, the district court reckoned that the retroactive benefits calculation method was promulgated in violation of the APA's notice and comment requirements. The Eighth Circuit rejected this rationale as well. 787 F.2d at 122.

MMS in reaching its determinations. *See* A.R., Vol. III, No. 1; Vol. VI, No.'s 1, 2, 3. There is no indication that the MMS would have calculated the royalties due any differently had it not used the Procedure Paper.

Phillips's Section 552 arguments are without merit.

Retroactive Application of the Procedure Paper

Phillips and ARCO claim that application of the Procedure Paper in this case violated prohibitions against retroactive agency action. This position is contingent on finding that the paper was a substantive rule. The ban on retroactive agency action applies only to new agency rules and agency rules adopted in an adjudicative proceeding. *See Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 208-209 (1988); *McDonald v. Watt*, 653 F.2d 1035, 1041-42 (5th Cir. Unit A 1981).

The Procedure Paper is neither such rule, and that which was being applied in the MMS orders at issue here was the already-existing Section 206.150. There was no retroactive application.

Validity of the MMS's Production Valuations

Lastly, the Court considers the remaining valuation issue: The validity of the MMS's production valuations with respect to the leases at issue in this case. Phillips and ARCO's challenges to the valuations rest on their views of the Procedure Paper.

When setting royalties, the Secretary of the Interior, and thus, the MMS, has a great deal of discretion in determining the value of NGLP production. *See Marathon Oil Co. v. United States*, 604 F. Supp. 1375, 1382 (D. Alaska 1985), *aff'd*, 807 F.2d 759 (9th Cir. 1986), *cert. denied*, 480 U.S. 940 (1987). More generally, in the words of the Fifth Circuit, "(w)e defer to an agency's interpretation of its governing statute and regulations, and affirm that interpretation if it has

a reasonable basis in law." *Freightcor Servs., Inc. v. Vitro Packaging, Inc.*, 965 F.2d 1339, 1343 (1992).

Phillips and ARCO have failed to demonstrate that the valuations ordered in this case were unreasonable. There is neither a challenge to the fairness of the Mont Belvieu spot price nor any indication that it is an improper embodiment of the requirements of Section 206.150.

Independently, because the MMS ordered that all of the recalculations at issue be done pursuant to the Procedure Paper, the recalculation orders are on firm footing; all of the MMS's orders were based on the paper and are permissible to the extent that they were so based.[36]

With respect to the MMS's valuations of production in this case, there is no showing of arbitrary or capricious acts and no showing of clear error in judgment. The MMS did not abuse its discretion in applying the Procedure Paper or in arriving at the valuations that it did.

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[36] Phillips also argues that the MMS has not complied with the Paperwork Reduction Act of 1980 ("PRA"), 44 U.S.C.A. §§ 3501-20 (West 1991 & Supp. 1992). The PRA requires that the Director of the Office of Management and Budget approve by issuing a control number the "collection of information" by an agency. *See id.* at § 3507. The MMS's orders requiring recalculation of royalties in this case contain no such numbers. As the Government notes, Phillips's argument amounts to an amended pleading and is, therefore, inappropriate pursuant Rule 15(a), Fed. R. Civ. P. Even were the argument vallowed, it would fail. The PRA "dose not apply to the collection of information. . . during the conduct of. . . an administrative action or investigation involving an agency against specific individuals or entities. . . ." 44 U.S.C.A. § 3518(c)(1) (West 1991). The MMS actions at issue here plainly qualify for this exemption.

VI. Conclusion

Phillips's Cross-Motion for Partial Summary Judgment and ARCO's Motion for Summary Judgment are GRANTED with respect to the statute of limitations issues, and the Government's Motion for Partial Summary Judgment is DENIED with respect to the same issues.

Therefore, the Government is precluded from bringing any causes of action against Phillips and ARCO based on royalty payments on the leases at issue here more than six years after the payments are due.

The Government's Motion for Partial Summary Judgment is GRANTED with respect to the Government's authority to order the royalty recalculations ordered by the MMS in this case. Phillips's Cross-Motion for Partial Summary Judgment and ARCO's Motion for Summary Judgment are DENIED with respect to the same issue.

The Government's Motion for Partial Summary Judgment is GRANTED with respect to the MMS's use of the Procedure Paper in the orders at issue in this case. Phillips's Cross-Motion for Partial Summary Judgment and ARCO's Motion for Summary Judgment are DENIED with respect to the same issue.

Therefore, the Court refuses to set aside the IBLA's decision in *Conoco, Inc., and ARCO Oil and Gas Co.*, 110 IBLA 232 (August 29, 1989).[37] This ruling also means that the Government is not precluded from employing the

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[37] ARCO also requested an allowance from the IBLA for transportation of its NGLP from a processing plant in Louisiana to Mont Belvieu, Texas. *See* ARCO's Memorandum in Support of Motion for Summary Judgment, filed August 16, 1991, at 24–26. The IBLA denied the allowance. Because the MMS's Royalty Management Program has no record that any such transportation took place and because ARCO has made no showing that it did, the Court will not set aside the IBLA's denial of the transportation allowance.

Procedure Paper in its royalty valuations or pursuing causes of action springing from Procedure Paper-based royalty valuations so long as such actions are not based on royalties due and owing for more than six years at the time the complaint is filed.

All other requested relief not expressly addressed in this Memorandum opinion and Order is DENIED.

SO ORDERED.

DATED: September 17, 1992.

/s/ Barefoot Sanders
Barefoot Sanders, Chief Judge
United States District Court
Northern District of Texas

APPENDIX I

United States Department Of The Interior

Mineral Management Service
Dallas Area Compliance Office
6126 E. 32nd Place
Tulsa, Oklahoma, 74135

September 27, 1989

HAND DELIVERED

Phillips Petroleum Company
Attention: Mr. S. M. Haugland
Senior Laws and Regulations Specialist
1090H Plaza Office Building
Bartlesville, Oklahoma 74004

Re: Gas Plants in Which Phillips Petroleum Company (Phillips) Had an Ownership Interest and Processed Gas Produced From Offshore Federal Leases From January 1977 through February 1988

Dear Mr. Haugland:

The United States Department of the Interior has completed audits of royalties paid by Aminoil Inc. (Aminoil) pertaining to offshore Federal leases. Specifically, the Office of Inspector General (OIG) conducted an audit of Aminoil's share of royalties paid on natural gas liquid products (NGLP's) for eight offshore Federal leases processed through the North Terrebonne Gas Processing Plant for the period January 1977 through December 1983. Phillips acquired the leases through the January 1, 1985, merger of Aminoil into Phillips. Aminoil based its NGLP royalty prices on sales to Aminoil Marketing Incorporated, which was 50 percent

owned by Aminoil. Royalties were understated as a result of valuing the NGLP's sold under non-arm's-length arrangements at less than the fair market value for royalty purposes. By letter dated January 28, 1986, Phillips was apprised of the preliminary underpayment of NGLP's royalties and voluntarily paid the additional royalties due through December 31, 1983.

By order dated April 17, 1986, Minerals Management Service (MMS) directed Phillips to review the royalty computations for Aminoil's share of the NGLP's produced at the North Terrebonne Gas Processing Plant for the period January 1984 through the present (February 1988) to assure that the royalty paid subsequent to the OIG audit was calculated using a market value which met the criteria set forth in the MMS Procedure Paper on Natural Gas Liquid Products Valuation (Procedure Paper) (Enclosure 1). Phillips appealed the order to the Director, Minerals Management Service, and subsequently appealed the Director's decision to the Interior Board of Land Appeals (IBLA). As of this date, the IBLA has not rendered a decision.

MMS has conducted a review of Phillips' share of NGLP's processed through the Rollover Gas Plant. The disposition of the NGLP's, except for ethane, were intercompany transfers or sales to affiliates which are considered as non-arm's-length transactions. The values used by Phillips did not consistently represent the fair market value for royalty purposes as outlined in the provisions of the Procedure Paper

The regulations at 30 CFR 206.150 (1987) state in part:

> The value of production shall never be less than the fair market value. The value used in the computation of royalty shall be determined by the Director.

The regulations at 30 CFR 206.152 (1987) state in part:

> (a) When gas is processed for the recovery of constituent products, a royalty established by the

terms of the lease will accrue on the value or amount of:

(1) All residue gas remaining after processing, and

(2) All natural gasoline, butane, propane, or other substances extracted from the gas. A reasonable allowance, determined by the Director and based upon regional plant practices and actual plant costs and other pertinent factors, may be made for the cost of processing and may be deducted from the royalty payment due on said constituent substances. However, the reasonable allowance shall not exceed two-thirds of the value of the substances extracted unless the Director determines that a greater allowance is in the national interest.

(b) Under no circumstances shall the amount of royalty on the residue gas and extracted substances be less than the amount which the Director determines would be payable if the gas had been sold without processing.

Based on the audits discussed herein and Phillips' responses thereto, the MMS considers a systemic or procedural deficiency to exist in the method used to calculate royalty due.

Accordingly, to correct the systemic deficiencies affecting the computation of royalty on production from offshore Federal leases, Phillips is directed to complete the requirements set forth in the following paragraphs:

1. Examine records of plant ownership and identify: (1) all offshore gas plants in which Phillips held an ownership interest from January 1977 through February 1988, and at which natural gas from Phillips' offshore Federal leases was processed; and (2) Phillips-owned offshore Federal leases which are associated with those plants and other plant owners leases for which Phillips pays

royalties. This shall include all interests acquired through mergers with other entities. Phillips is to provide this information by completing Enclosure 2 and returning the information to the MMS Resident Audit Team within 60 days of receipt of this order.

2. Within 90 days of receipt of this order, compute NGLP values for the period January 1977 through February 1988 for each of the gas plants identified pursuant to Item 1. For determining the reasonableness of NGLP values based on non-arm's-length transactions, the MMS policy is to apply procedures as set out in its Procedure Paper as modified by *Conoco Inc., ARCO Oil and Gas Co.*, 110 IBLA 232 (1989). The Procedure Paper now provides that if the NGLP's were disposed under non-arm's-length transactions, including transfers to affiliates, the unit values will be compared to the lowest prices published in commercial bulletins. If the value falls below the low price, it is considered unreasonable and unacceptable, and a value using the low price is used. Such values will be used for deriving a manufacturing allowance *and* for calculating royalties.

Copies of the computations will be provided to the MMS Resident Audit Team. Should the computations result in an increase in NGLP value, compliance with Items 3 and 4 will be required.

3. Within 120 days of receipt of this order, compute annual liquid value and expenses for the period January 1977 through February 1988 for each of the gas plants identified pursuant to Item 1 where the computations result in an increase in NGLP value. This information should be submitted to:

Minerals Management Service
Royalty Valuation and Standards Division
Post Office Box 25165, MS 653
Denver, Colorado 80225

Copies should be provided to the MMS Resident Audit Team. This order does not pertain to the North Terrebonne Natural Gas Processing Plant for the period January 1977 through February 1988. This plant, for the period specified, was addressed separately in the April 17, 1986 order.

4. Within 60 days of receipt of an approved plant-wide manufacturing allowance from MMS, recalculate royalties required by 30 CFR 206.152 and pay any resulting underpayments. Payment must be accompanied by properly completed green Report of Sales and Royalty Remittance (MMS-2014) forms using adjustment reason code 41 or 43, as appropriate. Your payment should be made in accordance with procedures outlined in 30 CFR 218.51. Appropriate late payment charges pursuant to 30 CFR 218.150 will be computed and billed to Phillips upon receipt of payment of additional royalties due. A copy of any payment made and related green MMS-2014 forms filed as a result of this directive should be provided to the MMS Resident Audit Team.

All supporting calculations and source documents are subject to audit by MMS, and therefore should be retained by Phillips until MMS completes its follow-up compliance testing. Our review of the other aspects of volume and values on which royalty is based are not complete. When that portion of our audit is final, we will notify Phillips of any additional exceptions concerning royalty determinations and payments.

Section 109 of the Federal Oil and Gas Royalty Management Act of 1982 (FOGRMA), promulgated in 30 CFR 241.51, authorizes MMS to assess civil penalties for failure or refusal to comply with the requirements of FOGRMA or any statute, regulation, rule, order, lease, or permit. Consequently, your failure to comply with the terms of this order may be considered a violation pursuant to 30 CFR 241.51(a)(3) and could subject you to penalties of up to $5,000 per violation per day for each day such violation continues.

You have the right to appeal in accordance with the provisions of 30 CFR 290. Any appeal taken will be to the Director, Minerals Management Service, and the notice of appeal must be filed with:

Nick L. Kelly, Area Manager
Dallas Area Compliance Office
Minerals Management Service
8303 Elmbrook Drive, Suite 110
Dallas, Texas 75247

within 30 days from the date of receipt of this order.

The notice of appeal must be accompanied by a written showing, as you deem adequate, to justify reversal or modification of this directive. Within the same 30-day period, the appellant will be permitted to file additional statements of reason or written briefs. You may also request, pursuant to 30 CFR 290.4, to present oral argument or evidence to the Director, Minerals Management Service, and such motion should be filed with the Director who may, at his discretion, schedule a hearing at a time and place of his choosing.

With the exception of the time fixed for filing a notice of appeal, the time for filing any document in connection with an appeal may be extended by the Director, Minerals Management Service. Any request for an extension of time must be filed within the 30-day period allowed for filing of the appeal document and must be filed with the same office in which the appeal document was filed.

In accordance with the provisions of 30 CFR 243.2 (1988), compliance with this order will be suspended upon the posting of an adequate surety in the form of a bond or letter of credit pending the outcome of the appeal. Adequate surety will be determined by developing a reasonable estimate of the amount due under the order, subject to the approval of the undersigned. Your proposal of the amount due under the

order must be sent to the address indicated above and must be received within 30 days after receipt of this order. The approved surety amount will include principal plus interest projected one year in advance and will be furnished to you along with instructions for posting surety. Upon request by MMS, the amount of surety will be increased periodically, if necessary, to cover any additional interest that may accrue.

If you have any questions concerning this order, contact Bob Rives at 918-581-6453.

Sincerely,

/s/Roy G. Williams for
Nick L. Kelly
Area Manager
Dallas Area Compliance Officer

3 Enclosures [omitted]

cc: Milton K. Dial, Chief
Royalty Valuation and
Standards Division

APPENDIX J

United States Department Of The Interior

Minerals Management Service
Dallas Area Compliance Office
6126 E. 32nd Place
Tulsa, Oklahoma 74135

September 26, 1989

HAND DELIVERED

Phillips Petroleum Company
Attention: Mr. S. M. Haugland
1090H Plaza Office Building
Bartlesville, Oklahoma 74004

Re: OCS-G 2712, Block A-561 High Island Area

Dear Mr. Haugland:

The Minerals Management Service (MMS) is reviewing royalties paid by Phillips Petroleum Company (Phillips) on oil and gas produced from Federal and Indian leases for the period October 1, 1980 through September 30, 1983. During two sample months, MMS determined royalties were underpaid by $6,950.16 on Federal Lease OCS-G 2712. This lease was acquired by Phillips in its merger with Aminoil Inc. (Aminoil). The underpayment resulted from Phillips' failure to pay royalty on all proceeds for production related costs recovered pursuant to Federal Energy Regulatory Commission (FERC) Orders 94 and 94A. This letter addresses only the specific exceptions outlined below; production volumes and values on all Phillips' properties are subject to further review.

MMS verbally notified Phillips of the royalty underpayment determination on August 7, 1989, and gave Phillips the opportunity to comment and review our calculations. Phillips notified MMS on August 16, 1989, that they were not going to verify our calculations nor comment on the issue.

The gas production sold from this lease is subject to the provisions of FERC Orders 94 and 94A under Section 110 of the Natural Gas Policy Act of 1978. On August 19, 1985, the United States Court of Appeals for the Fifth Circuit in *Texas Eastern Transmission Corporation, et al*, v. *FERC*, Nos. 83-4390 et al, affirmed FERC's decision to make certain production-related expenses recoverable from the effective date of Order 94. This decision confirmed that:

> . . . a price for the first sale of natural gas shall not be considered to exceed the maximum lawful price applicable to the first sale of such natural gas under this subtitle if such first sale price exceeds the maximum lawful price to the extent necessary to recover . . . any costs of compressing, gathering, processing, treating, liquifying, or transporting such natural gas, or other similar costs, borne by the seller and allowed for, by rule or order, by the Commission.

In addition to the Court's decision, MMS has determined that:

> Any monies received, or which could have been received, by the seller (lessee), for production-related costs, are a part of the gross proceeds upon which royalties are due.

Regulations at 30 CFR 206.150 (1985), entitled "Value basis for computing royalties", state in part:

> Under no circumstances shall the value of production be less than the gross proceeds. . . .

Consequently, royalties should have been paid on all proceeds for production related costs recovered pursuant to FERC

Orders 94 and 94A. The United States District Court for the Western District of Louisiana recently upheld an MMS order to pay royalty on reimbursement for production-related costs under FERC Order 94. *Mesa v. DOI*, Civ. No. 88-0414 LC (W. D. La., filed Aug. 23, 1989).

Our review shows that during May and June 1983, royalties were underpaid on Lease OCS-G 2712 due to royalties being paid on a gathering allowance of $.00408 per Mcf rather than the $.07 collected for each MMBtu sold (see Enclosure 1). Further review by MMS indicates that royalties were underpaid on Lease OCS-G 1025 due to the same issue. The error identified above appears to be systemic in nature. Therefore, within 30 days of receipt of this order, Phillips is directed to:

1. Review royalty calculations for all leases acquired by Phillips in its merger with Aminoil to determine if royalties were properly paid on all proceeds collected for production related costs. The two leases specifically discussed herein are leases acquired via the merger with Aminoil in 1985.

2. Recalculate royalties for all months from July 25, 1980, to the present, in instances where payments were not based on total proceeds received pursuant to FERC Orders 94 and 94A.

3. Pay all additional royalties due within 30 days of receipt of this letter. Payment *must* be accompanied by a properly completed *green* Report of Sales and Royalty Remittance (MMS-2014) form using adjustment reason code 41 or 43, as appropriate. Your payment should be made in accordance with procedures outlined in 30 CFR 218.51. Appropriate late payment charges pursuant to 30 CFR 218.150 will be computed and billed to Phillips upon receipt of payment of additional royalties due.

4. Provide MMS with a listing of all leases reviewed pursuant to this order.

A copy of the schedule of unpaid royalties in the format shown in Enclosure 2 along with copies of the green MMS-2014 forms, should be provided to this office within 30 days of your receipt of this letter. All documentation supporting your compliance with this order should be retained until MMS completes its follow-up compliance testing. Thereafter, on the subject lease and all other leases identified, Phillips should continue to value production for royalty purposes in accordance with regulations and guidelines discussed in this order. If in the future, we determine that the required accounting has not been performed and the future royalty payments do not comply with this order, the violation may be considered willful.

Section 109 of the Federal Oil and Gas Royalty Management Act of 1982 (FOGRMA), and regulations promulgated in 30 CFR 241.51, authorize MMS to assess civil penalties for failure or refusal to comply with the requirements of FOGRMA or any statute, regulation, rule, order, lease, or permit. Consequently, your failure to comply with the terms of this order may be considered a violation pursuant to 30 CFR 241.51 and could subject you to penalties of up to $5,000 per violation per day for each day such violation continues and up to $10,000 per violation each day if the violation is considered to be willful.

You have the right to appeal in accordance with the provisions of 30 CFR 290. Any appeal taken will be to the Director, Minerals Management Service, and the notice of appeal must be filed with:

Nick L. Kelly, Area Manager
Dallas Area Compliance Office
Minerals Management Service
8303 Elmbrook Drive, Suite 110
Dallas, Texas 75247

within 30 days from the date of receipt of this letter.

The notice of appeal must be accompanied by a written showing, as you deem adequate, to justify reversal or modification of this directive. Within the same 30-day period, the appellant will be permitted to file additional statements of reason or written briefs. You may also request, pursuant to 30 CFR 290.4, to present oral argument or evidence to the Director, Minerals Management Service, and such motion should be filed with the Director who may, at his discretion, schedule a hearing at a time and place of his choosing.

With the exception of the time fixed for filing a notice of appeal, the time for filing any document in connection with an appeal may be extended by the Director, Minerals Management Service. Any request for an extension of time must be filed within the 30-day period allowed for filing of the appeal document and must be filed with the same office in which the appeal document was filed.

In accordance with the provisions of 30 CFR 243.2, compliance with this order will be suspended upon the posting of an adequate surety in the form of a bond or letter of credit pending the outcome of the appeal. Adequate surety will be determined by developing a reasonable estimate of the amount due under the order, subject to the approval of the undersigned. Your proposal of the amount due under the order must be sent to the address indicated above and must be received within 30 days after receipt of this letter. The approved surety amount will include principal plus interest projected one year in advance and will be furnished to you along with instructions for posting surety.

If you have any questions, contact Bob Rives at 918-581-6453.

Sincerely,

/s/ Nick L. Kelly
Nick L. Kelly
Area Manager
Dallas Area Compliance Office

2 Enclosures [omitted]

APPENDIX K

United States Department Of The Interior

Minerals Management Service
Dallas Area Compliance Office
6126 E. 32nd Place
Tulsa, Oklahoma 74135

CERTIFIED MAIL--
RETURN RECEIPT REQUESTED

June 12, 1989

Phillips Petroleum Company
Attention: Ms. Jill E. Coble
1020 Plaza Office Building
Bartlesville, Oklahoma 74004

Gentlemen:

Re: Late Payment Charges, Federal Leases 054-002301-0 and 054-002302-0

The Minerals Management Service (MMS) notified Phillips Petroleum Company (Phillips) on March 21, 1989, that a review of royalty payments which were tendered for Federal leases and which were attributable to the provisions of Federal Energy Regulatory Commission (FERC) Orders 94 and 94A, Section 110 of the Natural Gas Policy Act of 1978, were found to be underpaid by $1,400.75. MMS's calculations pertained to the test months of June and July 1983. In response, Phillips recalculated royalties due for the period February 1982 through January 1984; and on March 31, 1989, remitted $59,951.19 in unpaid royalty. As a result of the late royalty payment, Phillips is assessed late payment charges totaling $24,074.72.

The regulations at 30 CFR 218.150 provide that failure to make timely or proper payment of any monies due pursuant

to leases subject to these regulations will result in the collection by MMS of the full amount past due plus a late payment charge. In accordance with 30 CFR 218.54, interest is assessed on all unpaid or underpaid amounts from the date the payments are due until the date payments are received in the appropriate MMS accounting office. Interest is charged only on the payments not received and only for the number of days the payment is late. Effective December 13, 1979, through May 31, 1982, the interest rate to be applied is calculated as the average of the highest rate for commercial and finance company paper of maturities of 180 days or less obtaining on each of the days incurred within the period for which the late charge is due. From June 1, 1982, through January 11, 1983, the percentage assessment rate to be applied is the rate prescribed by the Department of the Treasury as the "Treasury Current Value of Funds Rate" and is published in the Treasury Fiscal Requirements Manual Bulletins. Beginning January 12, 1983, pursuant to Public Law 97-451, Section 111, the rate applied is in accordance with Section 6621 of the Internal Revenue Code of 1954.

Accordingly, Phillips is assessed late payment charges of $21,512.33 for Lease 054-002301-0 and $2,562.39 for Lease 054-002302-0 from the date the payment was due through March 30, 1989. Computations of the applicable late payment charges are enclosed.

Your payment should be made in accordance with procedures outlined in 30 CFR 218.51. Payment is due by the date prescribed on the Bill for Collection and must be accompanied by a copy of the billing.

Section 109 of the Federal Oil and Gas Royalty Management Act of 1982 (FOGRMA), promulgated in 30 CFR 241.51, authorizes MMS to assess civil penalties for failure or refusal to comply with the requirements of FOGRMA or any statute, regulation, rule, order or permit. Consequently, your failure to comply with the terms of this order may be considered a

violation pursuant to 30 CFR 241.51(a) (3) and could subject you to penalties of up to $5,000 per violation per day.

You have the right to appeal in accordance with the provisions of 30 CFR 290. Any appeal taken will be to the Director, Minerals Management Service, and the notice of appeal must be filed with:

Nick L. Kelly, Area Manager
Dallas Area Compliance Office
Minerals Management Service
8303 Elmbrook Drive, Suite 110
Dallas, Texas 75247

within 30 days from the date of receipt of this letter.

The notice of appeal must be accompanied by a written showing, as you deem adequate, to justify reversal or modification of this directive. Within the same 30-day period, the appellant will be permitted to file additional statements of reason or written briefs. You may also request, pursuant to 30 CFR 290.4, to present oral argument or evidence to the Director, Minerals Management Service, and such motion should be filed with the Director who may, at his discretion, schedule a hearing at a time and place of his choosing.

With the exception of the time fixed for filing a notice of appeal, the time for filing any document in connection with an appeal may be extended by the Director, Minerals Management Service. Any request for an extension of time must be filed within the 30-day period allowed for filing of the appeal document and must be filed with the same office in which the appeal document was filed.

In accordance with the provisions of 30 CFR 243.2, compliance with this order shall not be suspended by reason of an appeal having been taken. An option is available to post surety in lieu of paying, pending the outcome of the appeal. The completed bond or letter of credit must be sent

to Chief, Payor Accounting Branch, Minerals Management Service, Royalty Management Program, Denver Federal Center, Building 85, Room A-212, Denver, Colorado 80225 and *must be received by the invoice due date*. The surety must be in the amount of $26,723.00 which includes the principal plus interest that will accrue through June 1990. Upon request by MMS, the amount of the surety will be increased periodically, if necessary, to cover any additional interest that may accrue. Enclosed are instructions for posting surety.

If you have any questions, contact Bob Rives at 918-581-6453.

Sincerely,

/s/ Roy G. Williams for
Nick L. Kelly
Area Manager
Dallas Area Compliance Office

5 Enclosures [omitted]

APPENDIX L

United States Department Of The Interior

Minerals Management Service
Dallas Area Compliance Office
6126 E. 32nd Place
Tulsa, Oklahoma 74135

June 5, 1989

HAND DELIVERED

Phillips Petroleum Company
Attention: Ms. Jill Coble
1020 Plaza Office Building
Bartlesville, Oklahoma 74004

Gentlemen:

The Minerals Management Service (MMS) is reviewing royalties paid by Phillips Petroleum Company (Phillips) on oil and gas produced from Federal and Indian leases for the period October 1, 1980 through September 30, 1983. During two sample months, MMS determined royalties were underpaid by $1,400.75 on Federal Lease OCS-G 2301. The underpayment resulted from the failure to pay royalty on all proceeds for production related costs recovered pursuant to Federal Energy Regulatory Commission (FERC) Orders 94 and 94A. This letter addresses only the specific exceptions outlined below; production volumes and values on all Phillips properties are subject to further review.

The lease is subject to the provisions of the FERC Orders 94 and 94A under Section 110 of the Natural Gas Policy Act of 1978. On August 19, 1985, the United States Court of Appeals for the Fifth Circuit in *Texas Eastern Transmission Corporation, et al,* v. *FERC*, Nos. 83-4390 et al, affirmed FERC's decision to make product-related allowances recoverable from the effective date of Order 94. This decision confirmed that:

> . . . a price for the first sale of natural gas shall not be considered to exceed the maximum lawful price applicable to the first sale of such natural gas under this subtitle if such first sale price exceeds the maximum lawful price to the extent necessary to recover . . . any costs of compressing, gathering, processing, treating, liquifying, or transporting such natural gas, or other similar costs, borne by the seller and allowed for, by rule or order, by the Commission.

In addition to the Court's decision, MMS has determined that:

> Any monies received, or which could have been received, by the seller (lessee), for production-related costs, are a part of the gross proceeds upon which royalties are due.

Regulations at 30 CFR 206.150, entitled "Value basis for computing royalties", state in part:

> Under no circumstances shall the value of production be less than the gross proceeds. . . .

Our review shows that during June and July 1983, royalties were underpaid due to Phillips paying royalties on gathering allowances of $.0051 per Mcf rather than the $.05 collected per MMBtu of gas produced. (See Enclosure 1.) MMS notified Phillips of the underpayment on Lease OCS-G 2301 by letter dated March 21, 1989. In response, Phillips paid royalty totaling $53,570.17 for Lease OCS-G 2301 and $6,381.02 for Lease OCS-G 2302 for the period February 1982 through January 1984. Further review by MMS also indicates that royalties were underpaid on Lease OCS 0301 due to the same issue. Therefore, within 30 days of receipt of this order, Phillips is directed to:

1. Review royalty calculations for all leases acquired by Phillips in its merger with General American Oil Company of Texas (GAO) to determine if royalties were

properly paid on all proceeds collected for production related costs. The three leases specifically discussed herein are leases acquired via the merger with GAO in 1983.

2. Recalculate royalties for all months from July 25, 1980 to the present, in instances where payments were not based on total proceeds received pursuant to FERC Orders 94 and 94A.

3. Submit any additional payment due in accordance with procedures outlined in 30 CFR 218.51 and report the payment to the Fiscal Accounting Division on *green* MMS-2014 forms (enclosed) using adjustment reason code 41 or 43, whichever is appropriate.

4. Provide MMS with a listing of all leases reviewed pursuant to this order.

A copy of the schedule of unpaid royalties in the format shown in Enclosure 2 along with copies of the green MMS-2014 forms, should be provided to this office within 30 days of your receipt of this letter. All documentation supporting your compliance with this order should be retained until MMS completes its follow-up compliance testing. Appropriate late payment charges pursuant to 30 CFR 218.150 will be computed and billed to Phillips upon receipt of additional royalties due. Thereafter, on the subject leases and all other leases identified, Phillips should continue to value production for royalty purposes in accordance with regulations and guidelines discussed in this order.

Section 109 of the Federal Oil and Gas Royalty Management Act of 1982 (FOGRMA), promulgated in 30 CFR 241.51, authorizes MMS to assess civil penalties for failure or refusal to comply with the requirements of FOGRMA or any statute, regulation, rule, order or permit. Consequently, your failure to comply with the terms of this order may be considered a

violation pursuant to 30 CFR 241.51(a) (3) and could subject you to penalties of up to $5,000 per violation per day.

You have the right to appeal in accordance with the provisions of 30 CFR 290. Any appeal taken will be to the Director, Minerals Management Service, and the notice of appeal must be filed with:

Nick L. Kelly, Area Manager
Dallas Area Compliance Office
Minerals Management Service
8303 Elmbrook Drive, Suite 110
Dallas, Texas 75247

within 30 days from the date of receipt of this letter.

The notice of appeal must be accompanied by a written showing, as you deem adequate, to justify reversal or modification of this directive. Within the same 30-day period, the appellant will be permitted to file additional statements of reason or written briefs. You may also request, pursuant to 30 CFR 290.4, to present oral argument or evidence to the Director, Minerals Management Service, and such motion should be filed with the Director who may, at his discretion, schedule a hearing at a time and place of his choosing.

With the exception of the time fixed for filing a notice of appeal, the time for filing any document in connection with an appeal may be extended by the Director, Minerals Management Service. Any request for an extension of time must be filed within the 30-day period allowed for filing of the appeal document and must be filed with the same office in which the appeal document was filed.

In accordance with the provisions of 30 CFR 243.2, compliance with this letter shall not be suspended by reason of an appeal having been taken. An option is available to post a bond as surety in lieu of paying, pending the outcome of the appeal. A request for stay of payment pending appeal

must be made within 30 days from the receipt of this letter and sent to the address indicated above.

If you have any questions, contact Bob Rives at 918-581-6453.

Sincerely,

/s/ Nick L. Kelly
Nick L. Kelly
Area Manager
Dallas Area Compliance Office

3 Enclosures [omitted]

APPENDIX M

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 93-1377

PHILLIPS PETROLEUM COMPANY,

Plaintiff-Appellant,

v.

GARY JOHNSON, Area Manager,
Dallas Area Compliance Office,
Minerals Management Service, et al.,

Defendants-Appellees.

ATLANTIC RICHFIELD COMPANY,

Plaintiff-Appellant,

v.

BRUCE BABBITT,
Secretary of Department of Interior, et al.,

Defendants-Appellees.

PHILLIPS PETROLEUM COMPANY,

Plaintiff-Appellant,

v.

GARY JOHNSON, Area Manager,
Dallas Area Compliance Office,
Minerals Management Service, et al.,

Defendants-Appellees.

PHILLIPS PETROLEUM COMPANY,

Plaintiff-Appellant,

v.

GARY JOHNSON, Area Manager,
Dallas Area Compliance Office,
Minerals Management Service, et al.,

Defendants-Appellees.

Appeals from the United States District Court
for the Northern District of Texas

ON PETITION FOR REHEARING AND SUGGESTION FOR REHEARING EN BANC

(Opinion 9/7/94, 5 Cir., 1994, F.3d____)

(November 1, 1994)

Before SMITH and BARKSDALE, Circuit Judges and WALTER, District Judge[1].

PER CURIAM:

(✓) The Petition for Rehearing is DENIED and no member of this panel nor Judge in regular active service on the Court having requested that the Court be polled on rehearing en banc, (FRAP and Local Rule 35) the Suggestion for Rehearing En Banc is also DENIED.

( ) The Petition for Rehearing is DENIED and the Court having been polled at the request of one of the members of the Court and a majority of the Judges who are in regular active service not having voted in favor, (FRAP and Local

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[1] District Judge of the Western District of Louisiana, sitting by designation.

Rule 35) the Suggestion for Rehearing En Banc is also DENIED.

( ) A member of the Court in active service having requested a poll on the reconsideration of this cause en banc, and a majority of the judges in active service not having voted in favor, rehearing en banc is DENIED.

ENTERED FOR THE COURT:

/s/ Jerry E. Smith
United States Circuit Judge

Judge Duhé did not participate in the consideration of the suggestion for rehearing en banc.